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99 742 OCT 25 1999
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No.

IN THE
Supreme Court of the United States

ALBERT AND ESTELLE BINDER,
in their individual capacities
and on behalf of all persons similarly situated,

Petitioners,

vs.

IAN R. WILSON, CARY S. FITCHEY, MARK L. STEVENS AND DELOITE & TOUCHE,

Respondents.

On Petition For Writ Of Certiorari To The Ninth Circuit Court Of Appeals

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Is the presumption of reliance afforded to plaintiffs alleging violations of Rule 10b-5 involving both misrepresentations and omissions restricted to claims constituting "primarily omissions"?

2. Does the absence of a presumption of reliance in a Rule 10b-5 case necessarily preclude class action status under FRCP Rule 23 and, in this case, decertification of the class?

3. Is there a presumption that an SEC reporting company's publicly traded stock, which is included in the National Association of Securities Dealer's electronic over-the-counter Bulletin Board trading system (reporting price and volume), is traded in an "efficient market" so as to entitle Rule 10b-5 claimants to a presumption of reliance under the fraud-on-the-market theory of recovery for such claims?

4. Were the plaintiffs, who had been determined to have similar Rule 10b-5 claims against other defendants remaining in the case, entitled to act as representatives of the class in respect of such class claims against Rule 10b-5 defendants against which the plaintiffs had no individual Rule 10b-5 claims?

In the instant case, having previously certified the instant Rule 10b-5 securities fraud case as a class action under Rule 23, the Idaho District Court dismissed all of the named plaintiffs and the class' Rule 10b-5 claims against the respondents and decertified the class, on the basis that such claimants were not entitled to a presumption of reliance under either *Affiliated Ute citizens* or *Basic, Inc.*

because the instant "mixed case" of misrepresentations and omissions alleged by the plaintiffs was "not primarily an omissions case" and the subject securities, of an SEC reporting company which were included for trading in the NASD's electronic over-the-counter "Bulletin Board" trading system during the class period (before such stock was also listed for trading on the Boston Stock Exchange), were not traded in an "efficient market" and, therefore, the claimants were not entitled to the fraud-on-the-market presumption of reliance enunciated by this Court in *Basic, Inc.*

LIST OF PARTIES

All parties to this proceeding, seeking review of the decision of the Ninth Circuit Court of Appeals, appear in the caption as presented on the facing page of this petition. (The following additional parties were named as defendants in the District Court action: Thomas Gillespie, Marie Mullen Gillespie, T. Gordon Sim, Diane Karban and John Good).

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Order and Opinion of the United States Court of Appeals for the Ninth Circuit dated July 26, 1999 (affirming the decision of the District Court of Idaho, denying petition for rehearing and for rehearing en banc). Majority opinion by Judges Skopil and Farris, and dissent by Judge Reinhardt 1a

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Petitioners Albert and Estelle Binder in their individual capacities and on behalf of all persons similarly situated (herein "Petitioner") respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The revised order and opinion of the United States Court of Appeals for the Ninth Circuit is reported at Binder v. Gillespie, 184 F.3d 1059 (9th Cir. 1999) (Appendix A). The order of the Idaho District Court dated February 14, 1997 in *Binder v. Gillespie*, et al, Case No. 94-0528-s-MHW (the "Order") is not published (Appendix B).[1/]

JURISDICTION

The date on which the United States Court of Appeals for the Ninth Circuit issued its revised opinion, and order denying the petition for rehearing and for rehearing en banc, was July 26, 1999.

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1). The primary basis for jurisdiction in the District Court was under 15 U.S.C. §78aa (Rule 10b-5 claims).

[1/] The second order of Idaho District Court dated July 3, 1997 (the "Second Order") was not published and is not believed to be meaningful for purposes of Court's consideration and action in respect of the within petition. (See "Statement Of The Case - - Procedural Background" herein at page 15).

STATUTES, REGULATIONS AND RULES INVOLVED

This petition implicates Section 10(b) of the Securities Exchange Act of 1934, as amended (the "34 Act"), and United States Securities and Exchange Commission ("SEC") Rule 10b-5 promulgated hereunder (Rule 10b-5). (Section 10(b) and Rule 10b-5 are collectively referred to herein as "Rule 10b-5") in respect of petitioner's submission that petitioner was entitled to a presumption of reliance on the respondents' misstatements as well as omissions in this "mixed" case of misstatements and omissions under this Court's decision in *Affiliated Ute Citizens* (and as referenced and confirmed in *Basic, Inc.*) and, separately, under this Court's decision in *Basic, Inc.* (fraud-on-the-market) because the public trading market for Aqua Vie Beverage Corporation stock which petitioner purchased in such public trading market satisfied all of the requirements of this Court's decision in *Basic, Inc.* The petition also implicates Federal Rules of Civil Procedure ("FRCP") Rule 23 in respect of the petitioner's submission that the lack of a presumption of individual reliance in a Rule 10b-5 public trading market case does not automatically preclude class action treatment and that the named plaintiffs' inability to satisfy the "purchaser or seller" requirement of a Rule 10b-5 action against all of the named defendants in the action does not automatically preclude such plaintiffs from serving as representative for class members who have similar Rule 10b-5 claims as those of the class representatives but against such other defendants. FRCP Rule 56 is also implicated in respect of petitioner's submission that the question of the "efficiency" of the trading market in AVBC stock should have been decided by the jury at trial.

The precise language of the above referenced statute and rules do not appear, however, to directly impact on the Court's decision in respect of the within petition; and, accordingly, such statute and rules are not reproduced in this section of the petition.

STATEMENT OF THE CASE[2/]

Factual Background

The Gillespies conceived of a new bottled water product which they described as a "lightly flavored spring water" product. Prior to such time, they had been marketing an unflavored spring water product from Hawaii. In January of 1991, the Gillespies acquired control of a public shell corporation (The Jib Group, Inc. or "Jib"), and changed its name to Aqua Vie Beverage Corporation ("AVBC" or the "Company"). The Gillespies moved from Hawaii to Sun Valley; and, in early 1991, Tom Gillespie ("Gillespie") hired Diane Karban, who had just passed her CPA exam in Idaho, as AVBC's chief accounting and financial officer. Karban, in turn, engaged Deloitte and Touche's Boise office to serve as AVBC's independent accountants and auditors. Prior to accepting such engagement, Deloitte never asked to and never did meet Gillespie. Deloitte dealt exclusively with Karban

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[2/] The within relevant facts were presented to the Court of Appeals in petitioner's opening brief to such Court together with citations to the record. The facts referenced in the opinion of the Court of Appeals do not appear to be inconsistent with any of the facts contained herein although the statement of facts set forth in such opinion is an abbreviated version of the within summary. Defendant Deloitte acknowledged, in its opposition to the petition for rehearing or rehearing en banc, that AVBC stock was included in the NASD's electronic OTC Bulletin Board trading system during the class period.

throughout 1991 and 1992. Deloitte went about trying to assemble accounting information regarding AVBC's 1990 operations; and Deloitte, with only minimum assistance from Karban, prepared AVBC's 1990 year-end financial statements including footnotes (based on the information Karban was able to get from Gillespie and give to Deloitte). Deloitte certified such AVBC 1990 year-end financial statements. Deloitte also prepared, with little or no assistance from AVBC, the Company's first couple of quarterly reports to the SEC on Form 10-Q. Deloitte thereafter regularly received, commented upon and otherwise participated in the preparation of such 10-Q reports together with "year-end results" and other press releases. Deloitte was referred to by name in AVBC's 1st Quarter 1991 10-Q Report as the Company's accountants who had classified certain of the information appearing in such quarterly financial statements. This Report also included the statement that the Company expected sales of its proposed new product to reach $10 million within 90 days following introduction. AVBC provided copies of its 1st and 2nd Quarter 1991 10-Q's to the petitioner. In 1991, having acquired control of Jib, and having caused public trading of AVBC stock to commence in February of 1991, Gillespie persuaded Frank Lopez, one of the former shareholders of Jib to sell his shares in AVBC in the public market, and to transfer the proceeds in the approximate amount of $700,000 to AVBC to be used as working capital. Lopez was promised but never received, replacement shares from the Company for the AVBC stock sold by him. Instead of recording such transfer of funds by Lopez to AVBC as a loan and recording a liability on AVBC's accounting books and records until such promised consideration was paid by the Company, Gillespie instructed that such funds transfer be reflected as a gift from Lopez, and Deloitte suggested the funds received from Lopez be classified as a "contribution to capital" (even though Lopez

was no longer a stockholder of AVBC following the sale of such stock). Deloitte, not AVBC, wrote a footnote to AVBC's quarterly and 1991 year-end financial statements describing such "contribution to capital" transaction. Deloitte never sent a "confirm" to Lopez or otherwise tried to communicate with Lopez regarding the subject funds transfer. AVBC's audited year-end financial statements reflected that the Company had received $678,589 from Lopez during the course of 1991, and that such funds were a "contribution to capital" from a shareholder of the Company. Lopez, having never received the promised "replacement" stock and having never recovered his money, sued and obtained AVBC's default in respect of such claim. Nevertheless, AVBC never recognized any liability in respect of the funds it received from and owed to Lopez. Ian Wilson was a director of the Company from October 1, 1992 through the end of the class period. Fitchey was associated with the Company for approximately the same period of time. Carey Fitchey used the title of "Office of the President" and he attended all board meetings and otherwise functioned as a senior level executive. Mark Stevens served on the board from May 1993 until the end of the class period. Stevens became President of AVBC in January of 1994, and resigned on February 28, 1994. Gillespie caused AVBC to enter into and announce an arrangement with Golden Brands in respect of distribution of the Company's new product. As part of the arrangement, Golden Brands ("GB") became AVBC's first "master distributor" in July of 1991, and GB agreed to advance funds to have AVBC's water product manufactured by an independent bottling company (Cottell). AVBC agreed to purchase and pay GB for such product to be used by AVBC for the launch of its new product to retail customers, including through the sale of such product to other distributors to be appointed by AVBC. AVBC's standard form of distributor agreement, which GB and

AVBC's subsequent distributors signed, included a provision obligating AVBC, at the option of the distributor(s), to repurchase all of such terminating distributor's saleable, but unsold, AVBC product. Such contingent liability was never reported or otherwise disclosed including in AVBC's financial statements. Prior to the first production run of AVBC's product in the Summer of 1992, AVBC's VP chief of quality control John Good reported to defendants Gillespie and Gordon Sim that the formula for the product was still not yet perfected and, as presently constituted, AVBC's product was most likely to turn brown shortly after it was manufactured based on simulated laboratory tests conducted by Good. Nevertheless, Gillespie and Sim decided to have AVBC go ahead with its initial production run because such product was needed for the scheduled retail launch of AVBC's new product in the late Summer/early Fall of 1992. AVBC never publicly disclosed that it was having any problem with the formula for its product (or that the Company's published pre-launch projections of anticipated sales revenue, ranging from $10 million in the first 90 days to $50-$100 million in first 12-24 months, were subject to any uncertainties). Likewise, AVBC never reported that it was obligated to GB in respect of the product which GB had arranged to be manufactured for AVBC. The initial Summer/Fall 1992 production run of AVBC's product in fact turned brown in the bottle as predicted by Good. AVBC later sought to stabilize the formula by adding an ingredient which was not on the FDA's list of approved chemical additives. Subsequent production runs indicated that, with the use of such additive, the product remained stable for a somewhat longer period of time before discoloring; and, on that basis, AVBC authorized another production run of the product by Cottell. Partly because of the discolored water, and partly because there were very few repeat retail purchases of AVBC's new product, GB

and AVBC knew, as early as the 4th Quarter of 1992, that the launch of AVBC's product had not been successful and that AVBC would, at least, be forced to re-formulate and re-name its product and to select an alternative program for the distribution and marketing of a "new and improved" version of such product. For this reason, and the fact that AVBC had failed to pay GB for the product manufactured by Cottell, despite numerous demands to and broken promises by AVBC, GB resigned as AVBC's distributor in late 1992 (and, thereafter, sued AVBC for amounts the Company owed GB). Through December 31, 1992, GB had accounted for approximately one-half (47%) of all sales reported by AVBC. In connection with GB's resignation, Gillespie, Wilson, and Fitchey confirmed to GB the agreement that AVBC would repurchase all defective (brown water) product remaining in GB and its subdistributors inventory, and all of such distributors' inventory of saleable but unsold AVBC product, for approximately $720,000. AVBC's debt to GB at the end of 1992 was not recorded or otherwise disclosed in AVBC's 1992 (or 1993) year-end financial statements, or in any of AVBC's published quarterly financial statements in 1992 or 1993. Likewise, AVBC did not reflect any expense including any reserve or liability attributable to the defective ("brown") water product (and did not adjust previously reported 1992 3rd and 4th Quarter sales of such product at year-end to reflect the return of such defective product). Without any purchases of product by GB in 1993, following such distributor's resignation at the end of 1992, and with only a few actual sales in the 1st Quarter of 1993, the Company's prior optimistic forecasts were clearly not materializing. In April of 1993, when AVBC's proposed securities offering registration statement was pending and set to go effective with the SEC, Gillespie instructed his accounting department to record approximately $425,000 in sales for the 1st Quarter of 1993

even though such product had not been shipped to or paid for by any customers (and never was). AVBC's accounting department was hesitant to implement Gillespie's instructions, which appeared to be contrary to GAAP and the Company's policy for recording sales, until such accounting treatment was reported to and "cleared" by Deloitte which did not object to such questionable reporting. When none of such 1st Quarter "sales" ever took place and AVBC still had not adjusted 1992 reported sales and/or recorded any loss or liability attributable to its product defect problem and/or obligation to GB through the end of 1992, in the Company's 1992 or 1993 year-end financial statements or in any quarterly financials extending through the 4th Quarter of 1993, AVBC reported in February 1994 that the Company would take a charge for the 4th Quarter of $425,000 "due to two master distributors who did not perform as expected". Thereafter, in AVBC's 1993 10-K Report, AVBC indicated it was recording a $1.7 million charge for the 1993 period attributable to "changing its distributor program" (which was a delayed recognition of the expenses/losses incurred by AVBC dating all the way back to the end of 1992 when GB resigned as a result of the product defect and failed launch of AVBC's product). AVBC had been effectively out-of-business since the end of 1992. Concurrently, Gillespie and Stevens announced the reformulation of AVBC's product to a new "All Natural" product which the Company said it was "rolling out nationwide" and which was expected to generate sales of approximately $14 million and $30 million, respectively, in the first and second years. Later in 1994, AVBC suspended business operations. In February of 1995, a bankruptcy petition was filed against AVBC. AVBC was liquidated in such bankruptcy proceeding. AVBC investors received nothing in respect of their AVBC stock.

The petitioner purchased 3,000 shares of AVBC stock on September 24, 1991 for $4 per share for a total of $12,000, and sold such stock on December 20, 1993 for $.875 per share for $2,625. Throughout the class period, AVBC was a public reporting company, filing periodic reports (10-K's, 10-Q's and 8-K's) with the SEC under Section 12(g) of the Securities Exchange Act of 1934. In September of 1992, AVBC filed and otherwise publicly disseminated a registration statement with the SEC under the Securities Act of 1993 covering the proposed sale of 2,000,000 shares of stock by AVBC (and its management) for $5.35 per share, which registration statement was amended several items through June of 1993 and included the consent of Deloitte for the use of its audit reports on AVBC's 1991 and 1992 year-end financial statement, and AVBC's quarterly financial statement for the three months ended March 31, 1993, which were included as part of such registration statement. During the class period August 1, 1991 through February 28, 1994, AVBC stock traded as high as $4.50 per share and had declined to $0.75 by the end of such period. Throughout the class period, trading in AVBC was in the OTC market and reported on a daily basis, on the NASD's electronic over-the-counter (OTC) "Bulletin Board" trading system and in the "pink sheets" published by the National Quotation Bureau, Inc. In addition to OTC market trading, in December of 1993 AVBC's stock was listed and began trading on the Boston Stock Exchange ("BSE"). Having published projections in 1991 indicating that sales were expected to exceed $50 million in the first twelve months, and in the 1st Quarter of 1991 stating that sales were expected to reach $10 million in the first 90 days following launch, AVBC's reported "sales" during 1992 did not exceed $1.3 million. Such "sales" were actually all fictitious in the sense that AVBC was obligated or otherwise liable for the repurchase of such merchandise due to the defective nature of such product

and/or pursuant to the repurchase provision in the Company's distributor agreements including with GB. For the 1st Quarter of 1993, of reported sales of $800,000, approximately $425,000 of such sales were bogus (non-existent). Accordingly, AVBC never really had any meaningful sales of its product. None of such information was ever reported in any of AVBC's audited year-end financial statements, in any of the Company's published quarterly financial statements or in any of AVBC's other disclosure documents including without limitation in any press release, annual report to stockholders, proxy statement, 10-K, 10-Q, 8-K or in the Company's pending registration statement. During the course of auditing and reporting on AVBC's financial statements, Deloitte never met Gillespie, and dealt exclusively with AVBC's accounting staff. Although Gillespie had no education, background or experience in accounting, Deloitte relied on written representations from Gillespie that the Company's financial statements were accurate and complete to the best of his knowledge. Although Deloitte's audit work papers, including written confirmation from AVBC's independent stock registrar/transfer agent in February of 1992, reflected that the number of AVBC shares issued and outstanding through December 31, 1991 did not include such shares, immediately prior to issuing its audit report on such 1991 financial statements in March 1992, Deloitte allowed AVBC to reflect the issuance of a free grant of 2.5 million shares of stock by AVBC to the Gillespies and Karban deemed effective January 9, 1991 (immediately after Gillespie took control of Jib and prior to the initiation of public trading of AVBC stock) valued for compensation/expense purposes at $.001 per share when the public trading price of such shares was far in excess of such amount.

The allegations of the First Amended Class Action Complaint (the "Complaint") state AVBC's projections of $50 million in sales in the first twelve months, and $10 million in the first 90 days following launch, were insupportable and were at best reckless if not intentionally fraudulent. AVBC did not disclose any information supporting the reasonableness of such projections. Thereafter, AVBC never disclosed any of the information which was known and which demonstrated such projections to be inaccurate. AVBC's financial statements reflected a development stage company which was moving forward in a positive manner when, in fact, just the opposite was true. Deloitte's presence as AVBC's auditor gave investors a false sense of assurance that they could rely upon the Company's published financial information when the opposite was true. AVBC's audited and unaudited financial statements reflected the Company as being in a position to be able to implement its announced business plan so as to obtain projections of profitability. *AVBC's 1992 financial statements should have, but did not, reflect that AVBC was experiencing problems with the formula for its product, and that the initial production runs of such product was defective and such defective product would have to be repurchased or replaced at an estimated cost of at least $180,000. Such financial statements should have reflected the Company's obligation to GB for product supplied by GB (through Cottell) to the Company, in the approximate amount of $500,000. Such financials should have reflected that GB had resigned as a distributor for AVBC's product.* None of this information was disclosed in AVBC's 1992, or 1993, year-end financial statements, rendering such statements and Deloitte's reports thereon false and misleading. AVBC's 1991 statements should have reflected that AVBC had received almost $700,000 from Lopez, without the payment of any consideration by AVBC for such funds, and that a liability in the amount of $700,000

had been recorded to reflect the receipt of such funds (or disputed transaction). If the foregoing had been properly reported in AVBC's 1992 year-end financial statements, investors would have known that AVBC had virtually no actual product sales in 1992, that any future significant sales of the product was in doubt, and that the Company's current liabilities, and the prospect of litigation with Lopez and GB, would seriously impede if not actually prevent the Company from conducting business in the ordinary course in 1993, and for the foreseeable future.

Procedural Background

The action was filed on March 4, 1994. The complaint including the First Amended Class Action Complaint ("Complaint") alleged violations of federal and state securities laws by AVBC, certain of its officers and directors including the Gillespies and defendants Wilson, Fitchey and Stevens (herein sometimes collectively the "O/D Defendants") and Defendant Deloitte.

Default was obtained against the Gillespies on July 15, 1994; and the plaintiffs' motion for default judgement under FRCP Rule 54(b) was granted by the Idaho court on July 3, 1997. Petitioner's motion for class certification under FRCP Rule 23 was granted on August 8, 1996. Sometime after February 1995, defendant AVBC was indicated to be the subject of an involuntary bankruptcy petition, and the instant case did not thereafter proceed against AVBC. The O/D Defendants and Deloitte filed motions for summary judgment on January 9, 1997. Plaintiffs and the class filed cross-motions for summary adjudication against Wilson (on their claims for breach of fiduciary duty only) and against Deloitte (on their Rule 10b-5 and related state law claims). On February 14, 1997,

the court issued its order of decision covering all such motions (the "Order"). The court granted the subject defendants' motions for summary judgement on the plaintiffs and the class' Rule 10b-5 claims under all theories of recovery (except the named plaintiffs' Rule 10b-5 claims based on his individual reliance on misstatements). The court dismissed the class' Rule 10b-5 claims based on individual reliance on misstatements because the court determined that the class was not entitled to rely upon the named plaintiffs' allegations of reliance on misstatements in the Complaint. The court also decided that the case could not proceed as a Rule 23 class action based on the remaining theory of reliance on misstatements because such individual issue would overwhelm the common issues rendering continued maintenance of the case as a class action untenable. The court dismissed the claimants' "omissions" case because the court found that such Rule 10b-5 claims were primarily based on misstatements (as opposed to omissions) and that, where a mixed case of misstatements and omissions is asserted, claimants are not entitled to a presumption of reliance/causation under this Court's decision in *Affiliated Ute Citizens* or *Basic, Inc.* on their fraud-on-the-market theory of recovery because the public trading market in AVBC stock, while such stock was trading in the OTC market, was not efficient (under factors enumerated in the New Jersey District Court case of *Cammer v. Bloom*, 711 F.Supp. 1264 (D.N. J.1989). For the period after December 1993 when AVBC stock began trading on the BSE, the court determined as a matter of law that factors *other than* AVBC's disclosure documents caused 100% of the losses suffered by AVBC investors. Believing that the only theory of recovery available to the claimants required individual reliance on AVBC's disclosure documents, and that such individual reliance based claims could not be established by the named plaintiffs, and that continued Rule 23 treatment was not available to the class

for purposes of their seeking recovery against the respondents, the Idaho District Court indicated that it was, therefore, necessarily compelled to decertify the class. The court also indicated that the lack of any remaining Rule 10b-5 claim by the class against the defendants, in whose favor judgment was being entered, required the court to decline further jurisdiction over the class' state law claims. The court ruled the claimants' cross-motion for summary judgment against defendant Wilson, based on state law, were rendered moot by the Order; and the court denied, without explanation, such claimants' cross-motion for summary judgment on their Rule 10b-5 and related state law claims against Deloitte. In light of the foregoing decision granting summary judgment in favor of respondents on the claimants' mixed misrepresentations and omissions case including fraud-on-the-market claims, the court refused to entertain further jurisdiction over the class' individual reliance based claims and the class' pendant state law claims; and the court decertified the class. The court subsequently confirmed that, by its Order, it intended to retain jurisdiction over the named plaintiffs' individual state law claims against the defendants (even though the court had declined to exercise jurisdiction over the class' state law claims against such defendants). Addressing the plaintiffs' remaining individual reliance and state law claims, the court indicated that it did not find "persuasive" the plaintiffs' evidence that Deloitte had any *substantive* involvement in the preparation of AVBC's quarterly financial statements and reports on Form 10-Q, so the court confirmed its prior finding and conclusion limiting the parameters of the plaintiffs' claims only to possible misstatements in, and the plaintiffs' individual reliance on, AVBC's year-end audited financial statements. In this regard, the court determined that the plaintiffs had already purchased their AVBC stock prior to the issuance of AVBC's 1991 year-end financial statements which was the

first such audited financial statements which the plaintiffs alleged they had read and relied upon (as opposed to the 1st Quarter 10-Q Report which was indicated to be unaudited), and prior to the date that Deloitte maintained AVBC's 1990 year-end financial statements had been filed with the SEC. Accordingly, the court determined that the "in connection with" element of Rule 10b-5 could not be satisfied in respect of plaintiffs' stock claim against Deloitte. The court, likewise, determined that the AVBC corporate disclosure information, including financial statements, upon which the plaintiffs could have actually relied in deciding to purchase AVBC stock, had been published prior to the time that the O/D Defendants (Wilson, Fitchey and Stevens) had any involvement with AVBC and that, consequently, plaintiffs could not satisfy the "in connection with" requirement in respect of such Defendants. The court did not address such Defendants' duty to disclose or correct, or fraudulent course of conduct, as a basis for recovery by the plaintiffs against such Defendants - - only the plaintiffs' ability to recover on their individual reliance on misstatements claims).

In a Second Order issued by the court, the Idaho District Court further concluded as a matter of law that AVBC's audited financial statements were not the cause of any injury suffered by the plaintiffs. Having concluded that dismissal of plaintiffs' individual Rule 10b-5 claims against the respondents was required, the court declined to retain jurisdiction over any of the named plaintiffs' state law claims against any of the defendants - - notwithstanding that the court determined at the same time to retain jurisdiction over state law claims against several of the other O/D defendants (including Karban, Good and Sim) because the court was not dismissing the named plaintiffs' claims against such other defendants. Having dismissed all of the plaintiffs' federal, and declined to retain jurisdiction over

any of the plaintiffs' state law, claims against the respondents, on July 3, 1997 the court entered final judgment in favor of such respondents under Rule 54(b). The named plaintiffs' Rule 10b-5 and state law claims against defendants Gordon Sim, Diane Karban and John Good remain pending before the court, but are being held in abeyance pending determination of the instant appeal.

REASONS FOR GRANTING THE PETITION

The opinion of the Ninth Circuit Court of Appeals which is the subject of this petition, includes decisions of important questions of federal substantive and procedural law applicable to this Rule 10b-5 securities class action case which are in conflict with relevant decisions of this Court; including *Basic, Inc. v. Levinson, Affiliated Ute Citizens v. United States, General Telephone Co. of Southwest v. Falcon, American Pipe & Construction Co. v. Utah and Crown Cork & Seal Co. v. Parker.*

To the extent that any of the matters decided by the Court Of Appeals on important questions of federal law as presented by this petition are determined not be in direct conflict with prior decisions of this Court, it is respectfully submitted that such questions are of such compelling national importance that the Court should grant this petition and settle such questions.

The questions presented are important and compelling as they affect the substantial number of Rule 10b-5 securities and other class action cases processed by the courts each year, the efficient system-wide administration of such cases and continued implementation of the anti-fraud purposes and objectives of the federal securities laws implicated by this petition for the protection

of the United States' capital markets and investors therein. In the past, this Court has reviewed and offered guidance in respect of the courts of appeal interpreting and applying FRCP Rule 23 in a manner which this Court believed did not fulfill the intended purpose and objective of such Rule. *American Pipe & Construction Co. v. Utah , Crown Cork & Seal Co. v. Parker, United Airlines, Inc. v. McDonald and General Telephone Co. of Southwest v. Falcon.*

For the reasons set forth herein, the Court is respectfully requested to grant this petition and decide the within important and compelling federal questions.

Claimants Were Denied The Presumption Of Individual Reliance Afforded Them Under Affiliate Ute

The majority cites *Affiliate Ute Citizens* as the basis for denying the claimants the benefit of a presumption of reliance in their mixed omissions and misrepresentations case which the Idaho District Court characterized as "not primarily an omissions case". Appendix, page 14a.[3/]

[3/] In *Affiliate Ute* involving both a material omission and a material misrepresentation, this Court indicated that positive proof of reliance is not a prerequisite to recovery if undisclosed facts would be material to reasonable investors. The majority's holding in this case, that *Affiliate Ute* should be restricted to cases involving "primarily omissions" may be as a result of an over emphasis on "omissions" (as opposed to undisclosed material facts resulting from misrepresentations as well as by way of "omission"). In *Basic, Inc.*, the Court appears to have indicated that *Affiliate Ute* should not be read to apply only to "omissions" (or "primarily omissions") as opposed to "misrepresentations" cases ("we previously have dispensed with a requirement of positive proof of reliance, where a duty to disclose material information has been breached, concluding that the necessary nexus between the plaintiff's injury and the defendant's wrongful conduct has been established") 485 U.S. at 243.

The Affiliated Ute presumption of reliance applies equally to misrepresentations and omissions. As Judge Reinhardt noted in his dissent on this point,

> "[t]he categories of 'omission' and 'misrepresentation' are not mutually exclusive . . . All misrepresentations are also nondisclosure, at least to the extent that there is a failure to disclose which facts in the misrepresentation are not true. Thus, the failure to report an expense item on an income statement, when such failure is material in the *Affiliated Ute* sense, can be characterized as (a) an omission of a material expense item, (b) a misrepresentation of income or (c) both."

Judge Reinhardt goes on to say that,

> "Omissions and misrepresentations both deprive the investor of truthful information relevant to the investment decision, and both result in the artificial pricing of a stock",

> "Most important for our purposes here, it is equally difficult to establish reliance on a misrepresentation and on an omission. While a plaintiff in an omissions case - - absent the Affiliated Ute presumption - - would bear the daunting task of proving 'I would not have bought/sold had I known what you failed to tell me . . . the plaintiff in a misrepresentation case bears the equally daunting burden of proving I would not have bought/sold had I know what you failed to tell me; namely, the truth'. In either case, the plaintiff must prove that he would have acted differently if he had known something that he did not actually know, i.e., the full truth."

> "In an omissions case, the plaintiff does not know the truth because the defendant said nothing; in a misrepresentations case the plaintiff does not know the truth because the defendant lied. But, as far as the plaintiff's ability to demonstrate reliance, this is a distinction without a difference. In either case, the plaintiff must attempt to prove that he would have acted differently had he known the truth. The evidentiary burden is therefore equally difficult in either case, and there is no logical reason to afford the presumption of reliance to plaintiffs in omissions cases but not in misrepresentations cases. The rule . . . that the 'causal nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock' . . . applies with equal force of logic to misrepresentations."

Judge Reinhardt concludes by stating

> "*Affiliate Ute* recognized the inherent difficulty of proving reliance in securities fraud cases, and accordingly announced a rule of presumed reliance in a mixed omissions and misrepresentations case . . . [P]laintiffs face the same difficulty in proving reliance on misrepresentations. I would therefore hold that plaintiffs in mixed cases are entitled to the *Affiliate Ute* presumption of reliance whether the case is primarily an omissions case or primarily a misrepresentations case. Accordingly, whether this case is properly classified simply as a mixed omissions and misrepresentations case, or as 'primarily' a misrepresentations case, I would hold that the Binder class was entitled to a presumption

> of reliance, and would therefore reverse the decertification of the class. [footnote omitted]".

This Court's "fraud-on-the-market" presumption of reliance as enunciated in *Basic, Inc.* does not differentiate between fraud occasioned by "omissions" versus "misrepresentations" and resulting nondisclosure. In *Basic*, referring to *Affiliated Ute*, this Court confirmed that, "we previously have dispensed with a requirement of positive proof of reliance, where a duty to disclose material information has been breached, concluding that the necessary nexus between the plaintiff's injury and the defendant's wrongful conduct has been established". 485 at 243.

Reliance on this Court's decision in *Affiliated Ute*, which was not a class action case (but face-to-face setting), to preclude the application of the judicial prerogative of a presumption of individual reliance in the context of this Rule 23 public trading markets case, combined with the erroneous conclusion that this Court's decision in *Basic, Inc.* precludes Rule 23 status absent the availability of a presumption of individual reliance[4], presents this Court with a compelling reason to grant the within petition and decide the issues presented by this case.

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[4] "[I]f a presumption is not allowed or is inapplicable the court would be required to decertify the class because individual issues of fact would predominate, thus rendering the class status untenable". Order (Appendix B) at page 17.

The Majority's Decision Is In Conflict With The Common Law Rule That Reliance May Be Inferred From The Materiality Of A Misrepresentation Or Omission

Under Common law, difficulties associated with relying on the claimant's own testimony led to the rule that reliance was best established as a result of the material nature of the fraud rather than the claimant's testimony as to what he would have done had he know the truth. See 27 Wright & Gold, *Federal Practice & Procedure: Evidence* 6005 at 57-58 (1990).[5/]

Proof Of Individual Reliance Does Not Necessarily Preclude Class Action Treatment

Virtually every Rule 10b-5 public trading markets case involves both misrepresentations and omissions and could be "characterized" as not involving primarily omissions thereby denying the plaintiff (and the class) of the benefit of a presumption of reliance and thus, according to the instant decision, treatment as a class action under Rule 23.[6/]

[5/] The majority decision is in conflict with centuries of common law holding that reliance may be inferred from the materiality of a misrepresentation or omission. See, e.g., *Loghry v. Capel*, 132 N.W.2d 417, 421 (Iowa 1965) (reliance inferred from materiality of omission); *Hicks v. Stevens*, 11 N.E. 241, 243 (Illinois 1887) (reliance "presume[d]" from materiality of misrepresentation). See also, 37 Am.Jur.2d *Fraud & Deceit* §228 at 305 (1968). Such common law principle was adopted by this Court in *Affiliated Ute* for claims under Section 10b-5. 406 U.S. at 153-54.

[6/] The Idaho Court quoted (Appendix at page 18b) the following language in *Basic*, apparently used by this Court to explain why it was appropriate to endorse the use of a presumption of indirect reliance on the

(continued...)

Accordingly, the majority's decision which is the subject of this petition appears to be inconsistent with this Court's decision, and/or the rationale underlying such decision as it relates to the application of a presumption of reliance in the context of a Rule 23 public trading markets securities case, in *Affiliate Ute* as confirmed in *Basic*. Moreover, application of this published decision in the Ninth Circuit and elsewhere will seriously erode the protections Congress and this Court have afforded to victims of securities fraud.

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[*] (...continued)
integrity of the market (tainted by the corporation's material omissions): "In approving the theory's presumption [fraud-on-the-market], the Supreme Court concluded that 'requiring proof of individual reliance from each member of the proposed class effectively would have prevented [plaintiffs] from proceeding with a class action, since individual issues would have overwhelmed the common ones'". 485 U.S. at 242. The irony of the court's decision is that, in foreclosing the claimants' use of a presumption of reliance on information withheld based on the "mixed case" rationale (adopted in only a very few cases in the 25 years since *Affiliated Ute* was decided, namely that a mixed case of misrepresentations and omissions does not present the claimant with the same difficulty of proof which would apply to an omissions only (or primarily an omissions) case which practical difficulty gave rise to the use of such presumption by courts as a way to facilitate intended recovery under Rule 10b-5), the court used the presumed "not so difficult proof" case and turned it into the "ultimate difficulty of proof" case by refusing to allow the case to proceed under Rule 23 as a result of the court's denial of such presumption of reliance decision and the court's misreading or misunderstanding of the language from this Court's decision in *Basic*.

The Characterization of This Case As "Not Primarily An Omissions Case" Is Not Accurate, Is Inconsistent With The Court's Own Description Of The Nature of The Case; And Such Approach Is Not Workable And Is In Any Event Unnecessary

Although the District Court in its Order generally described the gravamen of the plaintiffs' claims as a "failure to disclose" case, for purposes of denying the plaintiffs and the class the benefit of individual reliance for their Rule 10b-5 claims, the court then "characterized" plaintiffs' claims as "not primarily an omissions case".[7/] The majority said that they "do not disagree" with the District Court's characterization of the case. Appendix, page 12b.[8/] Neither the District Court or the majority in the opinion of the Court of Appeals provided any explanation, analysis, methodology, guidance or other comment as to why the instant action should be properly characterized as "not primarily an omission case". The gravamen of the case, as

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[7/] At the outset of its decision (Appendix, page 4b), the District Court stated that,

> "Essentially, Plaintiffs contend that over a two and a half year period AVBC created an overly optimistic picture of its future profitability in its public statements and thereby artificially inflated its stock price. *Plaintiffs contend that these projections were misleading when made because AVBC possessed adverse information at the time that it failed to disclose.*"
> (emphasis added).

[8/] The majority opinion: "The district court . . . characterized Binder's action as "not primarily an omissions case" and held that the *Affiliated Ute* presumption was unavailable. We agree with the district court's characterization of Binder's action. Binder's complaint contains both allegations of omissions and misrepresentations, and at the very least, must be characterized, as the district court noted, as "a mixed case of misstatements and omissions."

alleged in the complaint (Appendix C) and as maintained for purposes of the parties' cross motions for summary judgment, was that the O/D defendants knew, and Deloitte knew or was extremely reckless in not knowing that the formula for the AVBC water product was defective, that the water would and did actually turn brown in the bottle and that such product defect represented a contingent and actual liability adversely affecting AVBC's business, financial condition and prospects for success - - and that the Company's projections were, therefore, totally unrealistic if not intentionally fraudulent. None of such product defect and resulting information was ever disclosed to AVBC's investors. The instant case involves, as the District Court first indicated, a "failure to disclose" materially adverse information - - which information "touched-up" and actually caused AVBC's demise as a viable business proposition and investment.[9/]

The lack of guidance as to what constitutes an omission and a misrepresentation in the context of a securities fraud case, and the practical difficulty in distinguishing between the two, combined with the court's determination (citing *Basic, Inc.* as controlling authority) that the lack of a presumption of reliance precludes class action treatment in Rule 10b-5 cases, threatens the viability of most if not all of such claims and recovery for securities fraud as enunciated by this Court during the last decade.

[9/] The District Court apparently failed to realize that the publication and dissemination of AVBC's audited financial statements, which did not disclose such contingent and resulting actual liability in respect of such product defect, prior to and after the listing of AVBC's stock for trading on the BSE was the cause of AVBC's ultimate demise failure and the loss suffered by AVBC's investors.

Of course, this confusion should and would be eliminated if the Court grants the within petition and clarifies the questions presented hereby.

Claimants Were Denied The Fraud-On-The-Market Presumption Of Reliance Afforded Them Under Basic, Inc.

Basic, Inc. established that claimants are entitled to a presumption of reliance where such investors can be assumed to have relied on the efficiency and integrity of the public trading market for securities purchased at prices which were inflated by information introduced into such public trading market by defendants (who were under a duty to ensure the accuracy of such information) regardless of whether any resulting inaccuracy was the result of a "misrepresentation" and/or "omission". The concept underlying such judicial presumption is that efficient trading markets, by nature, will avail themselves of all available material information in determining the price at which securities are bought and sold.

The "efficient market" theory is not intended to be scientifically perfect in the context of judicial proceedings. It is an enabling rationale for the judicial presumption which enables the courts to more efficiently process these kinds of public trading market cases. The presumption is rebuttable. In determining whether any particular security is entitled to the indirect reliance or "fraud-on-the-market" presumption, whether such security is traded on a securities exchange or in the over-the-counter securities market, the threshold issue is whether or not information regarding the security and the issuer is available to participants in the trading market for such security. If so, it is logical to presume that professionals trading in such market will avail themselves of such information in determining the prices at

which they will buy and sell such security. Although it is true that AVBC stock was traded in the over-the-counter-market, at all times during the class period such Company was "an SEC reporting company" under the Securities Exchange Act of 1934 (and filed a Registration Statement with the SEC on Form S-1 under the Securities Act of 1933). At all times during the class period, AVBC stock was included in the National Association of Securities Dealers' Automated Quotation System OTC Bulletin Board system - - also referred to as the "over-the-counter" market. Such established, national electronic securities trading market (comprised exclusively of licensed securities professionals trading for their own account and the accounts of their customers) reports daily volume and prices for securities, including AVBC, included in such system.

The majority decision that the fraud-on-the-market presumption of reliance cannot apply because "Binder offered evidence only as to the presence of market makers and arbitragers" conflicts directly with the Supreme Court's holding in *Basic* that, "[f]or purposes of accepting the presumption of reliance . . . we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock prices". 485 U.S. at 246.[10/] For purposes

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[10/] The majority (Judge Reinhardt did not join in the fraud-on-the-market portion of the opinion) says that, "[t]he question is whether such a market is efficient - - whether the stock price reflects public information". Appendix at page 5a. The majority then purports to apply a "test" for efficiency from *Basic*, demanding "empirical facts showing a cause and effect relationship between unexpected corporate events and or financial releases and an immediate response in the stock price". But *Basic* adopts no such test. Indeed, in *Basic* this Court emphasized that, "[w]e need not determine by adjudication what economists and social scientists have debated through the use of sophisticated statistical analysis and the application of economic theory". 485 at 246, fn. 24. (For the record, plaintiffs submitted expert

(continued...)

of the application of the fraud-on-the-market presumption of reliance established by this Court in *Basic*, the securities of any company which is an SEC public reporting company (availability of the information which the SEC has determined to be important to the market for publicly traded securities) which trade in an impersonal, well-developed, open national securities trading market like the NASD Bulletin Board should be deemed to be trading in an "efficient market".

Petitioner was entitled to the benefit of the fraud on the market presumption of reliance enunciated by this Court in *Basic*, and the majority's opinion is contrary to the Court's determination on this important point of federal securities law and merits the granting of this petition.

A Rule 23 Representative Does Not Have To Have Claims Against The Exact Same Defendants As The Class

General Telephone v. Falcon established that a class representative does not have to possess the same claims against all of the same defendants, as each member of the class so long as common issues of fact and law predominate (which will normally be the case in a public trading securities case). Thus the fact that the petitioner bought AVBC stock following the date some of the class members

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[10/] (...continued)
testimony in response to the defendants' motions for summary judgment opining that the OTC market during the class period was "efficient" being an open, developed, national, impersonal securities trading market. Plaintiffs' also submitted a time and price summary of published newspaper reports reflecting the date of AVBC public announcements and the price movement of AVBC stock in response thereto showing the correlation underlying the economic principle of efficient markets - - which summary the District Court apparently declined to accept because the summary was not prepared by a person qualified as an expert).

petitioner was previously authorized to represent, and therefore could not satisfy Rule 10b-5's "purchaser or seller" requirement in respect of his individual claims as to all of the defendants, should not automatically disqualify him from pursuing not only his own Rule 10b-5 claims against the certain defendants remaining in the case following the Court's Order but also serving in a representative capacity for class members who have similar claims against other defendants. In justifying decertification of the class and dismissal of all of the class' Rule 10b-5 claims, solely on the basis that Binder could not maintain individual claims against all of the same defendants because he could not satisfy the purchaser or seller requirement as to all of such defendants, the majority opinion again failed to follow precedent of this Court.

CONCLUSION

The Court is respectfully requested to grant the within petition and clarify as necessary its prior decisions in *Affiliated Ute* and *Basic* so as to confirm the legal precedent established by such decisions on important questions of federal substantive and procedural law. The majority decision which is the subject of this petition affirms the Idaho District Court's misunderstanding of FRCP Rule 23 and Supreme Court cases interpreting such cases. The courts below concluded that, absent a presumption of reliance, no securities class action can proceed as such because the need for proof of individual reliance necessarily precludes maintenance of the case as a Rule 23 class action. Read together, the majority's belief that a presumption of reliance is available only in omissions or primarily omissions cases and that proof of individual reliance in a Rule 10b-5 case necessarily precludes class

action treatment under Rule 23 leaves most Federal securities law claimants without a remedy for fraud. The language in *Basic* which the Idaho court indicated it believed precluded class treatment ("requiring proof of individual reliance from each member of the proposed class effectively would have prevented [plaintiffs] from proceeding with a class action, since individual issues would have overwhelmed the common ones") is understood to have been intended by this Court not as a statement of the standard for class certification under Rule 23 for which it was adopted by the courts below, but as an acknowledgement of the realities of the practical difficulty of proof in securities class action cases justifying the adoption and liberal use of appropriate evidentiary presumptions.

For the reasons set forth herein, the Court should grant this petition.

Dated: October 23, 1999

Respectfully submitted,

ROBERT H. BRETZ, P.C.

By: /s/ Robert H. Bretz
Attorney for Petitioners

FILED
99 742 OCT 25 1999
OFFICE OF THE CLERK

No.

IN THE
Supreme Court of the United States

ALBERT AND ESTELLE BINDER,
in their individual capacities
and on behalf of all persons similarly situated,
Petitioners,

vs.

IAN R. WILSON, CARY S. FITCHEY, MARK L. STEVENS AND DELOITE & TOUCHE,
Respondents.

PETITION FOR WRIT OF CERTIORARI

APPENDIX

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APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ALBERT AND ESTELLE BINDER,
in their individual capacities and
and on behalf of one or more classes of
persons similarly situated,
Plaintiffs-Appellants,

vs.

THOMAS GILLESPIE; MARIE MULLEN
GILLESPIE; T. GORDON SIM;
DIANE L. KARBAN; JOHN A. GOOD
Defendants,

IAN R. WILSON; CARY S. FITCHEY; MARK L.
STEVENS; DELOITTE & TOUCHE; MARK STEVENSON
Defendants-Appellees.

Case No. 97-35943
D.C. No. CV-94-00528-MHW

ORDER AND OPINION

FILED JULY 26, 1999
CLERK, U.S. COURT OF APPEALS
FOR THE NINTH CIRCUIT

BINDER v. GILLESPIE

SUMMARY

Securities/Fraud

The court of appeals affirmed a judgment of the district court. The court held that the presumption of reliance set forth in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972) does not apply to a securities fraud action alleging both misstatements and omissions of material fact by the defendant.

Thomas and Marie Gillespie formed Aqua Vie Beverage Corporation (AVBC) in 1991 and hired appellee Deloitte and Touche as the company's accounting firm. AVBC stock began trading publicly on the over-the-counter (OTC) market. By August, the stock sold for S2.75 per share. In September, appellant Albert Binder bought 3000 shares at $4.00 per share.

AVBC's product experienced shelf-life problems. Its distributor resigned and sued for past-due debts. In December 1993, Binder sold his shares at less than a dollar per share. Binder brought a class action against the Gillespies, AVBC, its officers and directors, and Deloitte, alleging violations of § 10(b) of the Securities Exchange Act (SEA) and Rule 10b-5 of the Securities and Exchange Commission, as well as state-law claims. Except for AVBC and the Gillespies, the parties consented to proceedings before a magistrate judge (MJ). The MJ decertified the class of AVBC investors and dismissed all federal and state class claims. The MJ also granted summary judgment for

Deloitte and the officers and directors (appellees Ian Wilson, Mark Stevens, and Cary Fitchey). Binder's individual actions against the remaining defendants remained pending.

The MJ ruled that the claims by the class-investors who bought AVBC stock between August 1, 1991 and February 28, 1994-had to be dismissed because the class could not satisfy all elements of a claim under § 10(b) and Rule lOb-5. The MJ reasoned that the class would have to satisfy the reliance element of a securities-fraud claim through a presumption of reliance. and that no presumption was available because the action was not primarily a case involving the omission of material facts by the defendants.

The MJ noted that the class might qualify for a presumption of reliance as to stock purchased after it began trading on the Boston Stock Exchange, but elected to decertify for the period between December 1993 and February 28, 1994 on the ground that the class could not prove causation. The district court declined to exercise supplemental jurisdiction over Binder's related state-law claims.

Binder appealed, contending that he was entitled to the *Affiliated Ute* presumption of reliance. *Affiliated Ute* held that such a presumption is available in a securities fraud case when the complaint alleged omissions of material fact by the defendant. Binder also asserted that the class was entitled to a fraud-on-the-market presumption of reliance.

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[1] A securities fraud action requires proof of (1) a misrepresentation or omission (2) of material fact (3) made with scienter (4) on which the plaintiff justifiably relied (5) that proximately caused the alleged loss. [2] The *Affiliated Ute* presumption of reliance is generally available to plaintiffs alleging violations of § 1O(b) based on omissions of material fact. Binder's complaint contained allegations of both omissions of material fact and misrepresentations, and had to be characterized as a mixed case of misstatements and omissions.

[3] The Ninth Circuit has applied *Affiliated Ute* to cases that are, or can be, cast in omission or non-disclosure terms. *Affiliated Ute* should be confined to cases that primarily allege omissions, and [4] should not be applied to mixed cases of alleged misstatements and omissions unless the case can be characterized as one that primarily alleges omissions. Binder's class was not entitled to the *Affiliated Ute* presumption of reliance.

[5] The fraud-on-the-market presumption is based on the hypothesis that, in an open and developed securities market, the price of a stock is determined by the available material information regarding the company and its business. Misleading statements will therefore defraud purchasers of stock even if they do not directly rely on the misstatements. The presumption is available only when a plaintiff alleges that a defendant made material misrepresentations or omissions concerning a security that is actively traded in an efficient market, thereby establishing a fraud on the market.

[6] During the relevant period, AVBC's stock traded exclusively on the OTC market. Stocks in that market are listed on "pink sheets" that circulate daily and contain "bid" and "ask" prices, but do not include trading information. The question is whether such a market is efficient-whether the stock prices reflect public information.

[7] Factors designed to make the determination of effciency address five characteristics of the company and its stock: first, whether the stock trades at high weekly volume; second, whether securities analysts follow and report on the stock; third, whether the stock has market makers and arbitrageurs; fourth, whether the company is eligible to file SEC registration form S-3, as opposed to form S-l or S-2; and fifth, whether there are facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price. The district court determined that Binder offered evidence only as to the presence of market makers and arbitrageurs. That factor alone was insufficient to deem the market for AVBC stock efficient.

[8] The causation requirement in Rule 10b-5 securities fraud cases includes both transaction causation and loss causation, that the misrepresentations or omissions caused the harm. Transaction causation is equivalent to the element of reliance, or in tort liability terms, but-for

causation. The loss causation requirement, equivalent to proximate causation in tort, is satisfied if the plaintiff shows that the misrepresentation touches upon the reasons for the investment's decline in value.

[9] The MJ was correct in decertifying the class from December 1993 until February 1994. There was no showing of any material misrepresentations or omissions made during that period that could be said to have caused any investor loss.

[10] A district court may elect not to exercise supplemental jurisdiction over state claims if it has dismissed the original jurisdiction federal claims. Dismissal of the state-law class claims was not an abuse of discretion.

[11] Summary judgment was appropriate for Wilson, Stevens, and Fitchey. None of them had any role in AVBC prior to Binder's purchase of stock. A cause of action under §10(b) applies only to misrepresentations or omissions made in connection with the purchase or sale of any security. Only a purchaser or seller of securities has standing. Binder's statements that he would have sold his stock earlier but for AVBC's misrepresentations were irrelevant. Conduct actionable under Rule 10b-5 must occur before investors purchase the secureties. Only statements disseminated before September 24, 1991 could form the basis for Binder's individual claims.

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[12] The complaint alleged misrepresentations made prior to Binder's purchase, but only two implicated Deloitte. Those involved quarterly financial reports marked "unaudited." [13] Binder's evidence of Deloitte's participation in the reports was insufficient to preclude summary judgment. Judge Reinhardt dissented, writing that Binder was entitled to the presumption of reliance because the presumption applies to misrepresentations.

COUNSEL

Robert H. Bretz, Marina del Ray, California, for the plaintiffs-appellants.

Jeffery J. Ventrella, Elam & Burke, Boise, Idaho, for defendants-appellees Wilson, Fitchey, and Stevens.

Lois D. Thompson and Erik M. Silber, Proskauer Rose, Los Angeles, California, for defendant-appellee Deloitte & Touche.

ORDER

The majority opinion and dissent, reported at 172 F.3d 649 (9th Cir. 1999), is hereby withdrawn and superseded by the attached majority opinion and dissent. With the filing of these opinions, Judges Skopil and Farris vote to deny the petition for rehearing; Judge Reinhardt votes to grant rehearing. Accordingly, the petition for rehearing is **DENIED**.

The new majority opinion and dissent have been circulated to all active judges of the court, along with appellants' petition for rehearing en banc, amicus curiae brief in support of rehearing en banc, and appellees' briefs in opposition to rehearing en banc. No active judge has called for a vote en banc. Accordingly, the petition for rehearing en banc is **DENIED**.

OPINION

SKOPIL, Circuit Judge:

Albert Binder brought this action against Aqua Vie Beverage Corporation (AVBC), various AVBC officers and directors, and the accounting firm of Deloitte & Touche (Deloitte), asserting, on his own behalf and as a representative for a class of investors, that defendants violated federal and state securities laws. The district court decertified the class and declined to exercise supplemental jurisdiction over the related state law class claims. The court also granted summary judgment in favor of three AVBC officers and directors and for Deloitte on all of Binder's individual claims. Final judgments were entered pursuant to Federal Rule of Civil Procedure 54(b). We affirm.

I.

Tom Gillespie and Marie Mullen Gillespie formed AVBC in 1991 by purchasing a publicly owned shell

corporation and merging it with their Hawaii-based beverage company, KWC, Inc. They moved their operations to Sun Valley, Idaho. Shortly thereafter, Diane Karban joined the company as Chief Financial Officer and Deloitte was hired as the company's accounting firm. AVBC stock soon began trading publicly on the over-the-counter (OTC) market.

In the summer of 1991, Cottell Bottling agreed to manufacture, and Golden Brands agreed to distribute, AVBC's product - "lightly flavored," noncarbonated spring water. Industry publications touted AVBC as a promising, if speculative, investment, and AVBC stock sold for $2.75 per share by August. On September 24, 1991, Binder purchased 3000 shares at $4.00 per share. A month later, AVBC's bid price reached its peak at $4.50 per share.

AVBC began production in 1992. Chief of quality control John Good, however, warned CEO Tom Gillespie and consultant Gordon Sim that there was instability in the product formula. Sixty days after it was bottled, the water turned brown. AVBC adjusted the formula but continued to experience problems with the product's shelf life. By the end of the year, AVBC was forced to repurchase the defective water from Golden Brands. which eventually resigned as AVBC's distributor and sued for past due debts.

In 1993, AVBC struggled to raise funds and to establish a distribution network for its product. On December 29, 1993, Binder sold his 3000 shares at less

than one dollar per share. In 1994, AVBC suspended operations, and Binder filed this action. Default was entered against the Gillespies and, later, a default judgment for $5736.00. All remaining parties, except for defendants AVBC and the Gillespies, consented to proceedings before a magistrate judge. In February 1995, the action against AVBC was stayed pending Chapter 11 bankruptcy proceedings.

Chief Magistrate Judge Mike H. Williams decertified the class of AVBC investors and dismissed all federal and state class claims. He also granted summary judgment on all of Binder's individual federal and state claims against Deloitte and AVBC officers and directors Ian Wilson, Mark Stevens, and Cary Fitchey. The court entered final judgments pursuant to Rule 54(b). Meanwhile, Binder's individual actions against the remaining defendants are pending in district court.

II.

We begin our inquiry by examining whether we have jurisdiction to consider Binder's appeal. A magistrate judge may conduct civil proceedings and order the entry of judgment if the parties consent. 28 U.S.C. § 636(c); FED. R. CIV. P. 73(b). If the parties fail to consent in writing, the magistrate judge does not have jurisdiction and any judgment entered is a nullity. *See Aldrich v. Bowen*, 130 F.3d 1364, 1365 (9th Cir. 1997). A notice of appeal from such a judgment does not transfer jurisdiction to the court of appeals. See *Estate of Conners v. O'Connor*, 6 F.3d

656, 658 (9th Cir. 1993). Here, however, all parties to this appeal signed a stipulation consenting to proceedings before a magistrate judge. Accordingly, we conclude that Chief Magistrate Judge Williams had jurisdiction over this action and entered valid judgments. The notice of appeal properly conferred jurisdiction to this court.

III.

[1] Judge Williams ruled that claims by the class - AVBC investors who purchased stock between August 1, 1991 and February 28, 1994 - must be dismissed because the class could not, as a matter of law, satisfy all elements of a claim under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Securities and Exchange Commission (SEC) Rule 10b-5(b), 17 C.F.R. § 240. 10b-5. A successful securities fraud action requires proof of (1) a misrepresentation or omission (2) of material fact (3) made with scienter (4) on which the plaintiff justifiably relied (5) that proximately causes the alleged loss. *See Gray v. First Winthrop Corp.*, 82 F.3d 877, 884 (9th Cir. 1996).

The district court reasoned that the class would have to satisfy the reliance element through a presumption; otherwise individual questions of reliance would predominate over questions common to the class. *See* FED. R. CIV. P. 23(b)(3); *Basic Inc. v. Levinson*, 485 U.S. 224, 242 (1988) (noting that individualized proof of reliance by each class member would preclude a class action). The court concluded that no presumption was available under

the facts of the case, and, accordingly, decertified the class for the period until December 1993.

After that date, when AVBC stock began trading on the Boston Stock Exchange, Judge Williams acknowledged that the class might qualify for a presumption of reliance; however, he elected to decertify the class for the remaining period between December 1993 and February 28, 1994 on the ground that the class could not prove causation. That decision resulted in the dismissal of all class claims based on federal law and, because the court declined to exercise supplemental jurisdiction, it ended the state law class claims as well.

A.

[2] Binder argues that the class is eligible for a presumption of reliance pursuant to *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972). Such a presumption is generally available to plaintiffs alleging violations of section 1O(b) based on omissions of material fact. *See Kramas v. Security Gas & Oil.* Inc., 672 F.2d 766, 769 (9th Cir. 1982) (recognizing *Affiliated Ute* rule). The district court, however, characterized Binder's action as "not primarily an omissions case" and held that the *Affiliated Ute* presumption was unavailable. We agree with the district court's characterization of Binder's action. Binder's complaint contains both allegations of omissions and misrepresentations, and at the very least, must be characterized, as the district court noted, as "a mixed case of misstatements and omissions."

[3] We have applied the *Affiliated Ute* presumption to cases that "are, or can be, cast in omission or non-disclosure terms." *Blackie v. Barrack*, 524 F.2d 891, 905 (9th Cir. 1975); see also *Arthur Young & Co. v. United States Dist. Court*, 549 F.2d 686,694 (9th Cir. 1977). We have not squarely decided, however, whether the presumption may be invoked in a case involving misrepresentations or both omissions and misrepresentations. *See Little v. First Cal. Co.*, 532 F.2d 1302, 1305 n.4 (9th Cir. 1976) (noting that "[t]he categories of 'omission' and 'misrepresentation' are not mutually exclusive" and that a case involving a "representation from which material facts are omitted" presents "a true dilemma" because the plaintiff must show reliance, whereas the plaintiff in a pure omissions case may rely on the presumption); *Kramas*, 672 F.2d at 769 n.2 (noting that whether the presumption applies to misrepresentations had already been "twice reserved"). Nevertheless, in *Blackie*, we embraced the presumption because of the difficulty of proving a speculative negative" - that the plaintiff relied on what was not said. *Blackie*, 524 F.2d at 908. This suggests to us that *Affiliated Ute* should be confined to cases that primarily allege omissions.

Most circuits have limited the presumption accordingly. *See generally* Tim A. Thomas, Annotation, *When Is It Unnecessary to Show Direct Reliance on Misrepresentation or Omission in Civil Securities Fraud Action Under § IO(b) of Securities Exchange Act of 1934 (15 U.S. C.A. § 78J (B)) and SEC Rule 1Ob-5 (17 C.F.R.*

§ 240.10b-5), 93 A.L.R. FED. 444 (1989). A handful of circuits have addressed mixed cases, concluding that the preferred approach is to do as the magistrate judge did here and "analytically characterize [the] action as either primarily a nondisclosure case (which would make the presumption applicable), or a positive misrepresentation case." *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 359 (5th Cir. 1987); *see also Austin v. Loftsgaarden*, 675 F.2d 168, 178 n.21 (8th Cir. 1982) (agreeing with the Third Circuit that an analysis of plaintiffs allegations and an initial determination of burden of proof is more appropriate than a dual jury instruction in a mixed case).

[4] We agree with these circuits that the *Affiliated Ute* presumption should not be applied to cases that allege both misstatements and omissions unless the case can be characterized as one that primarily alleges omissions. Thus, Judge Williams' decision not to apply the presumption was sound and supported by the weight of authority. Accordingly, we agree with the district court that Binder's plaintiff class is not entitled to the *Affiliated Ute* presumption of reliance.

B.

[5] Binder also contends that the court erred by rejecting his contention that the class was entitled to a "fraud-on-the-market" presumption of reliance. The fraud-on-the-market presumption is "based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by

the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . ." *Basic, Inc.*, 485 U.S. at 241-42 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986)); *see also In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113-1114 (9th Cir. 1989). Thus, the presumption of reliance is available only when a plaintiff alleges that a defendant made material representations or omissions concerning a security that is actively traded in an "efficient market," thereby establishing a "fraud on the market." See Basic Inc., 485 U.S. at 247; *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 197 (6th Cir. 1990).

Judge Williams ruled that the class was ineligible for this presumption because the market for AVBC stock - which traded exclusively on the OTC market until December 1993 - was not efficient. Acknowledging "an absence of Ninth Circuit case law defining an efficient market," Judge Williams employed the five factors from *Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989), noting that the District Court for the Southern District of California had found the factors "helpful in determining whether the market is efficient," *See In re MDC Holdings Sec. Litig.*, 754 F. Supp. 785,804 (S.D. Cal. 1990); *see also Hayes v. Gross*, 982 F.2d 104, 107 n.1 (3d Cir. 1992) (noting *Cammer's* "thorough analysis"); *Freeman*, 915 F.2d at 199 (applying *Cammer* factors); *Hoexter v. Simmons*, 140 F.R.D. 416, 419 (D. Ariz. 1991) (same); *Harman v. Lyphomed, Inc.*, 122 F.R.D.

522, 525 (N.D. Ill. 1988) (applying factors identical to *Cammer*).

[6] During the relevant time period, AVBC's stock traded exclusively in the OTC market. Stocks in that market are listed on "pink sheets" that circulate daily and contain "bid" and "ask" prices, but do not include trading information, such as the volume of sales or the prices investors are actually paying. The question is whether such a market is efficient - meaning simply whether the stock prices reflect public information. *See Cammer*, 711 F. Supp. at 1281, 1282; *see also Hoexter*, 140 F.R.D. at 419 (concluding that the *Cammer* factors, rather than "the mere fact that the. . . shares were traded on the OTC market," supported preliminary finding of efficiency); *Hurley v. FDIC*, 719 F. Supp. 27, 33 (D. Mass. 1989). (Where the stock is traded is not the crucial issue. The important question is whether the stock is traded in a market that is efficient - one that obtains material information about a company and accurately reflects that information in the price of the stock."); *Harman*, 122 F.R.D. at 525 (noting that "the inquiry in an individual case remains the development of the market for that stock, and not the location where the stock trades"); *but see Epstein v. American Reserve Corp.*, No.79 C 4767, 1988 WL 40500, at *5 (N.D. III. Apr. 21, 1988) ("[W]e believe that the over-the-counter market is incapable of meeting the Supreme Court test [in *Basic Inc. v. Levinson*].")

[7] The *Cammer* factors are designed to help make the central determination of efficiency in a particular

market. They address five characteristics of the company and its stock: first, whether the stock trades at a high weekly volume; second, whether securities analysts follow and report on the stock; third, whether the stock has market makers and arbitrageurs; fourth, whether the company is eligible to file SEC registration form S-3, as opposed to form S-1 or S-2; and fifth, whether there are "empirical facts showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price." *Cammer*, 711 F. Supp. at 1286-87. The district court determined that Binder offered evidence only as to the presence of market makers and arbitrageurs. We agree with the district court that this factor alone is insufficient as a matter of law to deem the market for AVBC stock efficient. Accordingly, we affirm the court's decision to decertify the class through December 1993.

C.

After December 1993, AVBC stock began trading on the Boston Stock Exchange (BSE). The district court concluded that there was no showing that BSE was an inefficient market. The court nonetheless decertified the class for the remaining period from December 1993 to February 28, 1994 on the ground that Binder could not prove causation. The court concluded that during this time no false statements or omissions were made that could have caused Binder's loss. Rather, the court reasoned that some other factor or factors other than corporate

information and disclosures" caused the value of AVBC stock to decline.

[8] The causation requirement in Rule 10b-5 securities fraud cases includes "both transaction causation, that the violations in question caused the plaintiff to engage in the transaction, and loss causation, that the misrepresentations or omissions caused the harm." *McGonigle v. Combs*, 968 F.2d 810, 820 (9th Cir. 1992) (quoting *Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767, 773 (9th Cir. 1984)). The requirement of transaction causation is equivalent to the element of reliance, or, in tort liability terms, but-for causation. *See id.* at 821; Michael J. Kaufman,Loss Causation: Exposing a Fraud *on Securities Law Jurisprudence*, 24 IND. L. REV. 357, 359-61 (1991)(tracing the history of the causation requirement). The loss causation requirement, equivalent to proximate causation in tort, is satisfied if the plaintiff shows that "the misrepresentation touches upon the reasons for the investment's decline in value." *McGonigle*, 968 F.2d at 821 (quoting *Huddleston v. Herman & MacLean*, 640 F.2d 534, 549 (5th Cir. Unit A Mar. 1981), *rev'd in part on other grounds*, 459 U.S. 375 (1983)). That is, the plaintiff must show that the fraud caused, or at least had something to do with, the decline in the value of the investment after the securities transaction took place. *See* Kaufman, *supra* at 365 (criticizing the requirement as a potentially "insuperable barrier to recovery").

[9] Treatment of the loss causation requirement in this circuit and others has been less than clear. This resuits in part from the amorphous "touches upon" requirement. See *Id.* at 359-65. It also results from confusion between loss causation as a sub-element of the causation requirement, and loss causation as a calculation of damages. *See Robbins v. Koger Properties, Inc.*, 116 F.3d 1441,1447 n.5 (llth Cir. 1997) (noting the important distinction between loss causation and the proof of damages); *Movitz v. First Nat'l Bank of Chicago*, 148 F.3d 760, 765 (7th Cir. 1998) (apparently combining questions of loss causation and damages). Confusion aside, we conclude that Judge Williams was clearly correct in decertifying the class from December 1993 until February 1994. We agree that there was no showing of any material misrepresentations or omissions made during that period that can be said to have caused any investor loss.

IV.

[10] After decertifying the class, Judge Williams declined to exercise supplemental jurisdiction and, accordingly, dismissed the state class claims. Under 28 U.S.C. § 1367(c)(3), a district court may elect, in its discretion, not to exercise supplemental jurisdiction overstate claims if it has dismissed the original jurisdiction federal claims. *See Fang v. United States,* 140 F.3d 1238, 1241 (9th Cir. 1998); *Voigt v. Savell*, 70 F.3d 1552, 1565 (9th Cir. 1995). We conclude that dismissal of the state law class claims was not an abuse of discretion.

V.

After dismissing the federal and state class claims against all defendants, only Binder's individual federal and state claims remained. The magistrate judge granted summary judgment in favor of Wilson, Stevens, and Fitchey, as well as Deloitte on the federal causes of action. The court again declined to exercise jurisdiction over the pendent state law claims.

[11] We agree with the district court that summary judgment was appropriate for Wilson, Stevens, and Fitchey. None of these defendants had any role in AVBC prior to Binder's purchase of stock on September 24, 1991. Specifically, Wilson joined the board of directors in September or October 1992; Fitchey served as a consultant beginning in June 1992; and Stevens joined the board in July 1993. A cause of action under section 10(b) applies only to misrepresentations or omissions made "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b). Only a purchaser or seller of securities has standing to bring an action under section 10(b) and Rule 10b-5. See *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 749 (1975). Thus, Binder's statements that he would have sold his stock earlier but for AVBC's misrepresentations are irrelevant. *See Williams v. Sinclair*, 529 F.2d 1383, 1389 (9th Cir. 1975) (Shareholders "who did no more than retain their shares[ ] are. . . barred by the purchaser-seller rule from maintaining an action under Rule

10b-5."). As a matter of law, "conduct actionable underRule 10b-5 must occur before investors purchase the securities." *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1487 (9th Cir. 1991); *see also Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 651 (9th Cir. 1988). Accordingly, only statements or omissions disseminated before September 24, 1991 can form the basis for Binder's individuals claims.

[12] Binder contends that summary judgment was inappropriate for Deloitte because Deloitte prepared financial statements filed with the SEC before he purchased his stock. The complaint alleges misrepresentations made prior to Binder's purchase, but only two implicate Deloitte. Those involve quarterly financial reports issued by AVBC, marked "unaudited," which Binder nevertheless maintains were prepared with Deloitte's assistance.

Binder offers, as evidence of Deloitte's participation, a reference in the first quarter statement to AVBC's "certified public accountants, Deloitte & Touche." He also relies upon deposition testimony by a Deloitte employee who stated, "We did comment on their 10-Q's. "He neglects to include, however, the rest of the employee's testimony: "I would like to make one point clear, . . . that we never reviewed or had a business relationship with Aqua Vie that we were engaged to review their 10-Q's." In addition, the top of each section of the 10-Q forms was clearly marked "(unaudited)," and the completed forms were signed by Thomas Gillespie, with no mention (except the one reference) of Deloitte.

[13] We conclude that Binder's meager evidence or Deloitte's participation in the reports is insufficient to preclude summary judgment. A party opposing summary judgment must offer more than a mere scintilla of evidence; indeed, "[s]ummary judgment may be granted if the evidence is merely colorable. . or is not significantly probative." *Summers v. A. Teichert & Son, Inc.*, 127 F.3d 1150, 1152 (9th Cir. 1997) (internal quotation omitted). Based on the record before us, we agree with the district court that there are no factual issues that could "reasonably be resolved in favor of either party." *Id.* (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986)). We affirm the grant of summary judgment in favor of Deloitte.

VI.

Finally, Binder takes issue with various evidentiary rulings during the course of the proceedings in district court. Specifically, he contends that the court erred by denying his request to depose one of Deloitte's experts; by considering Deloitte's experts' reports over Binder's objections; and by refusing to consider portions of Binder's "Tollefson Declarations." We reject Binder's contentions. He has not demonstrated how additional discovery would have precluded summary judgment. *See Natural Resources Defense Council v. Houston*, 146 F.3d 1118, 1132-33 (9th Cir. 1998). Similarly, the judge stated that, in deciding to grant summary judgment, he "primarily relied on existing case law" rather than the expert reports. Therefore, even if some reports had been erroneously considered, the error was harmless. See *id.* at 1133. Finally, the "Tollefson

declarations" were properly struck because the court correctly concluded that Binder's expert lacked personal knowledge and was not shown to be competent to offer expert testimony.

AFFIRMED.

REINHARDT, Circuit Judge, dissenting in part:

Because the plaintiffs are entitled to a presumption of reliance under the doctrine of *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972), I would reverse the district court's decision to decertify the class of investors represented by Binder. I therefore respectfully dissent.[1]

In today's decision, the majority decides that the *Affiliated Ute* presumption does not apply to cases involving both material misrepresentations and material omissions, "unless the case can be characterized as one that primarily alleges omissions." (Opinion at 8329) In so holding, the majority resolves a question that we have previously, and explicitly, reserved: "whether *Affiliated Ute*

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1 I agree, however, with Part V of the opinion that summary judgment was appropriate for Binder's individual claims against Wilson, Stevens, Fitchey and Deloitte, and with the majority's conclusion in Part VI with respect to the evidentiary issues.

Citizens applies equally to misrepresentations." *Kramas v. Security Gas & Oil Co., Inc.*, 672 F.2d 766,769 n.2 (9th Cir. 1982). To reach this conclusion, the majority simply adopts the procedure followed by two other circuits. *See Finkel v. Docutel/Olivetti Corp.* 817 F.2d 356, 359 (5th Cir. 1987); *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749, 756 (11th Cir. 1984). Those circuits have determined that, in mixed cases, it is necessary to "analytically characterize [the] action as either primarily a nondisclosure case. . . or a positive misrepresentation case." *Finkel*, 817 F.2d at 359. I believe, however, that the logic behind the *Affiliated Ute* decision and the reasoning contained in our decisions implementing *Affiliated Ute* make it clear that the presumption applies equally to misrepresentations, and that it is irrelevant whether the case is primarily a misrepresentations case or primarily an omissions case. In either event, the plaintiff is entitled to a presumption of reliance.[2]

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2 To be sure, plaintiffs in any 10b action must have actually relied on the material omission or misrepresentation in order to recover damages. *See* 15 U.S.C. § 78j(b). I do not dispute this. As discussed below, I believe only that plaintiffs in mixed cases are entitled to a *presumption* of reliance whether the case is primarily an omissions case or primarily a misstatements case. None our other 10b cases is to the contrary. It is true that in *Paracor Finance, Inc. v. General Elec. Capital Corp.*, 96 F.3d 1151, 1159 (9th Cir. 1996), and *Smolen Deloitte, Haskins, & Sells*, 921 F.2d 959, 963-64

In *Blackie v.Barrack*. 524 F.2d 891, 908 (9th Cir. 1975), on which the majority relies, we examined a material omissions case in which the plaintiff bought stock based in part on material omissions made by the defendant. We examined the *Affiliated Ute* rule and concluded that the *Blackie* plaintiffs did not need to prove reliance. We explained that such proof would require "proof of a speculative negative." *Id.* In other words, to establish reliance, the plaintiff would have to prove the following proposition: ..I would not have bought had I known." *Id.* We rejected such a requirement because:

> Direct proof would inevitably be somewhat proforma, and impose a difficult evidentiary burden, because addressed to a speculative possibility in an area where motivations are complex and difficult to determine. . . . Here, the requirement [of proving reliance] is redundant - the same causal nexus can be adequately established indirectly, by proof of materiality coupled

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(9th Cir. 1990), we recited the general rule that investors must demonstrate reliance on an alleged misrepresentation. Neither *Paracor nor Smolen* was a mixed case, however, and in neither case were we called on to determine whether the investors might be entitled to a presumption of reliance under the *Affiliated Ute doctrine*. Our holding in both cases was merely that the investors did not, in fact, rely on the misstatements.

> with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock.

Id. Because *Blackie* was a pure omissions case, we did not have occasion to determine whether the same reasoning would apply to material misrepresentations. One year later, however, in *Little v. First California Co.*, 532 F .2d 1302, 1305 n.4 (9th Cir. 1976), we stated the rather obvious proposition that "[t]he categories of 'omission' and 'misrepresentation' are not mutually exclusive." As we wrote:

> All misrepresentations are also nondisclosures, at least to the extent that there is a failure to disclose which facts in the representation are not true. Thus, the failure to report an expense item on an income statement, when such a failure is material in the *Affiliated Ute* sense, can be characterized as (a) an omission of a material expense item, (b) a misrepresentation of income, or (c) both.

Id. This observation, besides being binding upon us as a matter of law, is clearly correct as a matter of logic. Omissions and misrepresentations both deprive the investor of truthful information relevant to the investment

decision, and both result in the artificial pricing of a stock.

Most important for our purposes here, it is equally difficult to establish reliance on a misrepresentation and on an omission. While a plaintiff in an omissions case absent the *Affiliated Ute* presumption would bear the daunting task of proving 'I would not have bought/sold had I known what you failed to tell me' see *Blackie*, 524 F.2d 908, the plaintiff in a misrepresentation case bears the equally daunting burden of proving 'I would not have bought/sold had I known what you failed to tell me; namely, the truth.' In either case, the plaintiff must prove that he would have acted differently if he had known something that he did not actually know, i.e., the full truth.

In an omissions case, the plaintiff does not know the truth because the defendant said nothing; in a misrepresentations case the plaintiff does not know the truth because the defendant lied. But, as far as the plaintiff's ability to demonstrate reliance, this is a distinction withhout a difference. In either case, the plaintiff must attempt to prove that he would have acted differently had he known the truth. The evidentiary burden is therefore equally difficult in either case, and there is no logical reason to afford the presumption of reliance to plaintiffs in omissions cases but not in misrepresentations cases. The rule we announced in *Blackie*, that the "causal nexus can be adequately established indirectly, by proof of materiality coupled

with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock," *id.*, applies with equal force of logic to misrepresentations.

The Third Circuit made a similar observation in *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 188 (3d Cir. 1981). *Sharp* involved both material omissions and misrepresentations. The *Sharp* court noted that the reason for "shifting the burden on the reliance issue has been an assumption that the plaintiff is generally incapable of proving that he relied on a material omission." *Id.* The court concluded, however, that "this observation does not justify a clear distinction between the treatment of misrepresentations and omissions." *Id.* As the Third Circuit put it:

> [T]he problem of speculation is not unique to situations in which omissions have occurred. In misrepresentation actions as well, proof of reliance requires a degree of speculation on the action that the plaintiff would have taken had no misrepresentation occurred.

Id.

Affiliated Ute recognized the inherent difficulty of proving reliance in securities fraud cases, and accordingly announced a rule of presumed reliance in a mixed omissions and misrepresentations case. As suggested by

our opinion in *Little* and by the Third Circuit in *Sharp*, plaintiffs face the same difficulty in proving reliance on misrepresentations. I would therefore hold that plaintiffs in mixed cases are entitled to the *Affiliated Ute* presumption of reliance whether the case is primarily an omissions case or primarily a misrepresentations case. Accordingly, whether this case is properly classified simply as a mixed omissions and misrepresentations case, or as "primarily" a misrepresentations case, I would hold that the Binder class was entitled to a presumption of reliance, and would therefore reverse the decertification of the class.[3]

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3 A different question, one not presented here, is whetther plaintiffs are entitled to a presumption of reliance in pure misrepresentation cases. Dicta in *Paracor*, 96 F.3d at 1159, and *Smolen*, 921 F.2d at 963-64, might be read to suggest that plaintiffs in pure misrepresentation cases are required to demonstrate reliance affirmatively. Especially given the fact that we did not consider, in either case, whether a presumption of reliance would have been appropriate, and that our holding in neither case resolved the question, *see supra* n.2, I would not read the dicta in such way. In light of the logic of *Affiliated Ute*, and for the reasons I have outlined above, I would hold (were I called on to reach the qustion) that plaintiffs are entitled to a presumption of reliance in pure misrepresentation cases.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT

ALBERT AND ESTELLE BINDER,
in their individual capacities and
and on behalf of one or more classes of
persons similarly situated,
Plaintiffs,

vs.

THOMAS GILLESPIE, MARIE MULLEN GILLESPIE,
IAN R. WILSON, T. GORDON SIM, DIANE L. KARBAN,
CARY S. FITCHEY, LEE STRADER, JOHN A. GOOD,
ROBERT BAHOSHY, MARK L. STEVENS, AQUA VIE
BEVERAGE CORPORATION AND DELOITTE &
TOUCHE
Defendants

Case No. 94-0528-S-MHW

ORDER

FILED FEBRUARY 14, 1999
CLERK, U.S. DISTRICT COURT
FOR THE DISTRICT OF IDAHO

Currently pending before this Court are the following motions:

1. Defendants Wilson, Sim, Stevens and Fitchey parallel and revisited motion to dismiss (Dkt. #74) filed April 19, 1996;

2. Defendants Wilson, Sim, Stevens and Fitchey motion for protective order (Dkt. #132) filed June 5, 1996;

3. Defendant Deloitte & Touche's motion for sanctions (Dkt. #152) filed June 25, 1996;

4. Defendant Deloitte & Touche's motion for protective order (Dkt. #165) filed July 11, 1996;

5. Defendant Deloitte & Touche's motion to strike certain allegations from the first amended complaint (Dkt. #221) filed December 11, 1996;

6. Defendant Deloitte & Touche's motion for protective order precluding certain depositions (Dkt. #227-1) filed December 27, 1996;

7. Defendant Deloitte & Touche's motion to require the Plaintiff to show cause why he should be permitted to conduct more depositions (Dkt. #227-2) filed December 27, 1996;

8. Defendant Deloitte & Touche's motion to dismiss state law claims (Dkt. #300) filed January 29, 1997;

9. Defendants Wilson, Sim, Stevens and Fitchey motion to dismiss state law claims (Dkt. #238 filed January 6, 1997;

10. Defendants Wilson, Sim, Stevens and Fitchey motion for summary judgment (Dkt. #248) filed January 9, 1997;

11. Defendants Wilson, Sim, Stevens and Fitchey motion for redesignation of Fitchey affidavit (Dkt. #257) filed January 9, 1997;

12. Defendant Deloitte & Touche's motion for summary judgment (Dkt. #259) filed January 9, 1997;

13. Plaintiffs' motion for summary judgment (Dkt. #269-1) or for partial summary adjudication on Plaintiffs' claims against Defendant Deloitte & Touche (Dkt. #269-2) filed January 14, 1997;

14. Plaintiffs' motion for summary judgment (Dkt. #274-1) or for partial summary adjudication on Plaintiffs' claims against Defendant Ian Wilson (Dkt. #274-2) filed January 14, 1997;

15. Defendant Deloitte & Touche's motion to strike supplemental case authority (Dkt. #283) filed January 21, 1997;

16. Defendants Wilson, Sim, Stevens and Fitchey motion to strike the Tollefson declaration (Dkt. #303) filed January 28, 1997;

17. Defendant Deloitte & Touche's motion to strike the declaration of Tollefson in support of Plaintiffs' motion for summary judgment (Dkt. #308) filed January 28, 1997;

18. Defendant Deloitte & Touche's motion to strike the declaration of Tollefson (Dkt. #316) filed January 30,1997;

19. Defendants Wilson, Sim, Stevens and Fitchey motion to strike the declaration of Daniel Luciano (Dkt. #341) filed February 4, 1997;

20. Defendant Deloitte & Touche's motion to decertify the class (Dkt. #348) filed February 5, 1997.

On February 6, 1997, the Court conducted a hearing, and has fully reviewed the motions and related pleadings and is now sufficiently prepared to issue a ruling in this matter .

BACKGROUND

Plaintiffs Albert and Estelle Binder[1] bring this class action suit in their individual capacity and on behalf of a class of investors who purchased stock of Defendant Aqua Vie Beverage Corporation (" AVBC") during the class period, August 1, 1991, through February 28, 1994. In addition to AVBC, the Defendants include AVBC's officers and directors, Thomas Gillespie, Marie Mullen Gillespie, Ian Wilson, T. Gordon Sim, Diane Karban, Cary Fitchey, Lee Strader, John Good, Robert Bahoshy and Mark Stevens, as well as Deloitte & Touche, AVBC's independent auditor .

Essentially, Plaintiffs contend that over a two and a half year period AVBC created an overly optimistic picture of its future profitability in its public statements and thereby artificially inflated its stock price. Plaintiffs contend that these projections were misleading when made because AVBC possessed adverse information at the time that it failed to disclose. Plaintiffs

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[1] Subsequent to the filing of this action, Estelle Binder died, and Albert Binder succeeded to 100% ownership of the shares of AVBC stock previously owned by him and his wife.

allege these actions violate federal and state securities law and state common law.

Specifically, Plaintiffs assert claims against all the Defendants based on violation of federal securities law, namely Section 10b and Rule 10b-5, and for violation of similar statutes under Idaho state securities law. In addition, Plaintiffs allege that all the Defendants are liable under Idaho state common law for fraud, constructive fraud, negligent misrepresentation, and negligence based on a special relationship. Moreover, Plaintiffs assert a Section 20(A) federal securities law claim against Defendant Diane L. Karban and a Section 20 federal securities law claim against Defendants Thomas Gillespie and Marie Mullen Gillespie. Finally, Plaintiffs allege a California state law claim[2] for controlling person liability against Thomas Gillespie and Marie Mullen Gillespie and a Delaware state law claim for breach of fiduciary duty against all Defendants except Deloitte & Touche.

The Defendants have moved to decertify the class. The Court concludes as a matter of law that a class action can no longer be certified by the Court under Fed. R. Civ. P. 23(a) and (b) since Plaintiffs can no longer prove essential elements for a class action under Section 10b and Rule 10b-5 asserted in Count One against the Defendants. As such, the Court is required to decertify the class[3] on those claims because individual issues of

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[2] Plaintiff amended the complaint to allege Idaho state law. This cause of action should be brought pursuant to Idaho state securities law for controlling person liability. I.C. § 30-1446(2) (1996).

[3] The Court points out that the decertification of the class does not impact Mr. Binder's right to proceed

fact would predominate over common ones. However, the remaining federal claims, Count Two against Defendant Diane L. Karban for insider trading and Count Three against Defendants Thomas Gillespie and Marie Mullen Gillespie for controlling person liability will remain in dispute. The decertification of the class as to Count One authorizes the Court to decline to exercise class action supplemental jurisdiction over the state law claims alleged against the Defendants, except for Count Six against Defendants Thomas Gillespie and Marie Mullen Gillespie for controlling person liability.

The Court will first address the parties' motions for summary judgment or partial summary adjudication. Next, the Court will dispose of the various motions accompanying the parties' motions for summary judgment. The Court will then take up any miscellaneous motions that arose during the discovery-phase of this litigation and finally any remaining motions.

MOTIONS FOR SUMMARY JUDGMENT

The parties advance various motions for summary judgment, seeking the Court to rule in their favor as a matter of law. Defendant Deloitte & Touche moves for summary judgment on Plaintiffs' Count One, a federal securities law claim under Section 1Ob and Rule 10b-5. (Dkt. #276). Plaintiffs move for summary judgment, or in the alternative, partial summary

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individually. The foregoing order only addresses the pending motions based on the class status of the action and does not address whether Mr. Binder's individual claims would be subject to dismissal. Further, the Court does not address any individual defenses that a Defendant may have against Mr. Binder personally.

adjudication on all Plaintiffs' causes of action against Deloitte based on alleged deficiencies in Deloitte's audited 1991 and 1992 year-end financial statements. (Dkt. #269). In addition, Defendants Wilson, Sim, Stevens and Fitchey, the "Wilson Defendants", move for summary judgment on both Plaintiffs' federal securities law claims and state law claims. (Dkt. #248). Finally, Plaintiffs move for summary judgment, or in the alternative, partial summary adjudication, on Count Ten of the Complaint against Defendant Ian Wilson for breach of fiduciary duty. (Dkt. #274).

Summary Judgment Standard:

When reviewing a motion for summary judgment, the proper inquiry is whether "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."[4] A moving party who does not bear the burden of proof at trial may show that no genuine issue of material fact remains by demonstrating that "there is an absence of evidence to support the non-moving party's case."[5] Once the moving party meets the requirement of Rule 56 by either showing that no genuine issue of material fact remains or that there is an absence of evidence to support the non-moving party's case, the burden shifts to the party resisting the motion who "must set forth

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[4] Fed. R. Civ. P. 56(c) (1993).

[5] *Celatex Carp v. Catrett*, 477 U.S. 317, 325, 106 S.Ct. 2548,91 L.Ed.2d 265 (1986).

specific facts showing that there is a genuine issue for trial."[6] It is not enough for the [non-moving] party to "rest on mere allegations of denials of his pleadings."[7] Genuine factual issues must exist that "can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party. "[8]

"When determining if a genuine factual issue. . . exists, . . . a trial judge must bear in mind the actual quantum and quality of proof necessary to support liability."[9] "The mere existence of a scintilla of evidence in support of the [defendant's] position will be insufficient; there must be evidence on which the jury could reasonably find for the [defendants]."[10] The Ninth Circuit has consistently applied this standard for granting summary judgment.[11]

In determining whether a material fact exists, facts and inferences must be viewed most favorably to the non-moving party. To deny the motion, the Court need only conclude that a

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[6] *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256, 106 S.Ct. 2505,91 L.Ed.2d 202 (1986).

[7] Id.

[8] Id, at 250.

[9] Id., at 249-50.

[10] Id.

[11] *Musick v. Burke*, 913 F.2d 1390 (9th Cir. 1990); *Pelletier v. Federal Home Loan Bank*, 968 F.2d 865 (9th Cir. 1992); *Bieghler v. Kleppe*, 633 F.2d 531 (9th Cir. 1980).

result other than that proposed by the moving party is possible under the facts and applicable law .[12]

The Ninth Circuit has recently emphasized that summary judgment may not be avoided merely because there is some purported factual dispute, but only when there is a "genuine issue of material fact."[13] In order to withstand a motion for summary judgment, the non-moving party:

(1) must make a showing sufficient to establish a genuine issue of fact with respect to any element for which it bears the burden of proof; (2) must show that there is an issue that may reasonably be resolved in favor of either party; and (3) must come forward with more persuasive evidence than would otherwise be necessary when the factual context makes the non-moving party's claim implausible. [14]

1. Deloitte & Touche's Motion for Summary Judgment

Defendant Deloitte & Touche moves for summary judgment (Dkt. #259) on Plaintiffs' federal securities law claim, the first cause of action, asserting that Plaintiffs cannot prove essential elements of the claim. Plaintiffs' Count One is based on

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[12] *Aronsen v. Crown Zellerbach*, 662 F.2d 584,591 (9th Cir. 1981).

[13] *Hanon v. Dataproducts Corp.*, 976 F2d 497 (9th Cir. 1992).

[14] *British Motor Car Distrib. Ltd. v. San Francisco Automotive Indus. Welfare Fund*, 882 F.2d 371 (9th Cir. 1989).

Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

Section 1Ob of the Securities Exchange Act of 1934 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange ---

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[15]

One such rule prescribed by the Commission is Rule 10b-5 which accompanies Section 1Ob. Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a

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[15] 15 U.S.C. § 78j(b) (1934 Act).

> fraud or deceit upon any person, in connection with the purchase or sale of any security .[16]

Elements of Section 1Ob and Rule 1Ob-5 Claim

The main purpose of Section 1Ob and Rule 10b-5 is to protect investors from fraud and prevent fraudulent practices in securities trading. [17] In combination, these two provisions are often alleged, and the elements to prove a claim under Section lOb and Rule 10b-5 are not in dispute. To prove a claim for Sections lOb of the Securities Exchange Act and Rule 10b-5 a plaintiff must show:

> (1) a misrepresentation or omission or other fraudulent device; (2) a purchase or sale of securities in connection with the fraudulent device; (3) scienter by defendant in making the misrepresentation or omission; (4) materiality of the misrepresentation or omission; (5) justifiable reliance by plaintiff (or due diligence against it); and (6) damages resulting from the fraudulent device.[18]

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[16] 17 C.F.R. § 240. 10b-5 (1987).

[17] See, *Travis v. Anthes Imperial, Ltd.*, 473 F.2d 515 (8th Cir. 1973); *Alabama Farm Bureau Mut. Casualty Co. v. American Fidelity Life Ins. Co.*, 606 F.2d 602 (5th Cir. 1979) *reh'g den*, 610 F.2d 818, *cert den*, 449 US 820, 66 L.Ed 2d. 22, 101 S.Ct 77.

[18] See, *Basic v. Levinson*, 485 U.S. 224, 108 S.Ct. 978,99 L.Ed.2d 194 (1988); *McCormick v. Fund American Companies*, 26 F.3d 869 (9th Cir. 1994); *Monroe v. Hughes*, 31 F.3d 772 (9th Cir. 1994); *Warren v. Reserve Fund, Inc.*, 728 F.2d 741 (5th Cir. 1984) *reh den* 734 F.2d 14-79 (1984); *Marksman Partners L P. v. Chantal*

1. Misrepresentation or Omission

Plaintiffs allege that Deloitte misstated AVBC's true state of affairs and omitted material facts from financial statements audited on behalf of AVBC. The alleged misrepresentations include: (1) reporting the infusion into AVBC of $678,589 by Lopez as a contribution to capital instead of as a liability in the 1991 year-end Financial Statements; (2) reporting the issuance of 2.5 million shares of AVBC stock to Thomas Gillespie and Diane Karban for $.001 per share in violation of Generally Accepted Accounting Practices ("GAAP"); (3) reporting projected sales of $10 million in the first ninety days in the First Quarter 10-Q, 1991; (4) reporting the Lopez funds as a contribution to capital instead of a liability in the Second and Third Quarter 10-Q, 1991; (5) reporting sales which did not occur and reporting in the stockholders' equity account money from stock subscriptions not yet received in the First Quarter 10-Q, 1993; and (6) reporting falsely a special charge for unshipped product in the amount of $425,000 in the 1993 year-end Press Release.

Plaintiffs further allege that Defendants omitted facts from the audited financial statements, including that: (1) as of December 31, 1992, AVBC owed their distributor, Golden Brands, approximately $500,000 for product that had to be returned; (2) a substantial amount of AVBC product turned brown and was defective; (3) AVBC agreed to repurchase all defective product; (4) AVBC owed Lopez $678,589 for money allegedly loaned to company; and (5) AVBC management falsified the corporate books regarding the issuance of stock to certain management personnel.

Pharmaceutical Corp., 927 F.Supp. 1297 (C.D.Cal. 1996); *Robert Freedman v. Louisiana-Pacific Corp.*, 922 F.Supp. 377 (D.Ore. 1996).

Plaintiffs maintain that Deloitte had a duty to correct prior information transmitted via the financial statements and allege that the failure to correct such misstatements and omissions satisfies the first element for Section lOb and Rule 10b-5 liability.

2. Purchase or Sale of a Security

Plaintiffs are class members who allegedly purchased AVBC common stock during the relevant class period, August 1, 1991, through February 28, 1994.

3. Scienter

Scienter, as defined by case law, relates to the mental state involved in selling securities with the intent to deceive, manipulate or defraud[19] and includes a reckless misrepresentation or failure to disclose a material fact.[20] Recklessness involves not merely simple or inexcusable negligence, but an "extreme departure from the standards of ordinary care. . . which presents a danger of misleading buyers

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[19] *Ernst & Ernst v. Hochftelder*, 425 U.S. 185, 194 n.12, 96 S.Ct. 1375, 1381, n.12, 47 Led.2d 668 (1976), reh'g denied, 425 U.S. 986, 96 S.CT. 2194, 48 L.Ed.2d 811 (1976); *Aaron v. SEC* 446 U.S. 680, 686 n.5, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980).

[20] *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569-70 (9th Cir. 1990), cert. denied, 499 U.S. 976, 111 S.Ct. 1621,113 L.Ed.2d 719 (1991); *SEC v. Burns*, 816 F.2d 471,474 (9th Cir. 1987).

or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it".[21]

Because mental state or intent is difficult to prove with direct proof, it is often "inferred from a series of seemingly isolated acts and instances which have been aptly designated as badges of fraud."[22] To establish scienter by circumstantial evidence, the allegations must "support a strong inference that defendants acted with an intent to defraud the market."[23] For corporateofficers, knowledge is generally imputed since it is reasonable to presume that group published publications are the collective actions of the corporate officers.[24]

Plaintiffs allege that the information contained in the financial statements audited and reported on by Deloitte were false and misleading and omitted material facts which

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[21] *Montgomery Securities v. Dannenburg*, _____ U.S._____ , 116 S.Ct. 274, 133 L.Ed.2d 195 (1995); *In re Software Toolworks, Inc.* , 50 F.3d 615, 626 (9th Cir. 1994), cert. denied sub nom.

[22] *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390, n.30, 103 S.Ct. 683,692, n.30, 74 L.Ed.2d 548 (1983); *Walters v. United States*, 256 F.2d 840 (9th Cir. 1958), *cert. denied* 358 U.S. 833 (1958); *Deaver v. United States*, 155 F.2d 740,744 (D.C.Cir. 1946), *cert. denied* 329 U.S. 766 (1946); *Nassan v. United States*, 126 F.2d 613, 615 (4th Cir. 1942).

[23] *Marksman Partners, L.P. v. Chantal Pharmaceutical Corp.* , 927 F.Supp. 1297, 1313 (C.D.Cal. 1996).

[24] *Wool v. Tandem Computers, Inc.* , 818 F.2d 1433, 1442 (9th Cir. 1987).

circumstantially prove that Deloitte intended to defraud Plaintiffs through the sale of securities.

4. Materiality of the Misrepresentation or Omission

Materially misleading statements or omissions by a defendant constitute the primary element of a Section lOb and Rule 10b-5 cause of action.[25] A false statement or omission will be considered material if its disclosure would alter the total mix of facts available to an investor and "if there is a substantial likelihood that a reasonable shareholder would consider it important" to the investment decision.[26]

A fact is material if its existence or nonexistence is a matter to which a reasonable person would attach importance in determining his choice of action in the transaction.[27] In addition, the question of materiality is a mixed question of law and fact, but involves "assessments peculiarly within the province of the

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[25] *Basic, Inc. v. Levinson*, 485 U.S. 224,231-32, 108 S.Ct. 978,983-84, 99 L.Ed.2d 194 (1988)

[26] Id.; see also *Kramas v. Security Gas & Oil Inc.*, 672 F.2d 766, 769 (9th Cir. 1982), *cert. denied*, 459 U .S. 1035, 103 S.Ct. 444, 74 L.Ed.2d 600 (1982); *Roots Partnership v. Lands' End, Inc.*, 965 F.2d 1411, 1420 (7th Cir. 1992).

[27] *TSC Industries v. Northway, Inc.*, 426 U .S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976); *Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301, 1306 (9th Cir. 1982) (citing *Northwest Paper Corp. v. Thompson*, 421 F.2d 137, 138 (9th Cir. 1969); *SEC v. Murphy*, 626 F.2d 633,643 (9th Cir. 1980).

trier of fact"[28] and is determined in light of facts existing at the time of nondisclosure or misinformation.[29] Materiality is usually a jury question because it requires an assessment of the inferences that a reasonable shareholder would draw from a given set of facts.[30]

Plaintiffs assert that the misrepresentations and omissions alleged in the Complaint are material because AVBC investors and future investors would have taken those misstatements and omissions into account in determining whether to hold, buy, or sell AVBC stock.

5. Justifiable Reliance

The Ninth Circuit follows the rule that there is a rebuttable presumption of reliance when a defendant allegedly fails to disclose, or omits, material information.[31] In addition, it is proper to presume reliance when the transaction is completed

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[28] *Arrington v. Merrill Lynch, Pierce, Fenner & Smith*, 651 F.2d 615,619 (9th Cir. 1981); see also *TSC Industries*, 426 U .S. at 450, 96 S.Ct. at 2133

[29] *SEC v. Texas Gulf Sulfer*, 401 F.2d 833,863 (2nd Cir. 1968).

[30] *Price Co v. Fecht*, 70 F.3d 1078, 1080 (9th Cir. 1995), *cert. denied*, _____U.S.____, 116 S.Ct. 1422, 134 L.Ed.2d 547 (1996); *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir. 1985).

[31] *Blackie v. Barrack*, 524, F.2d 891, 905-06 (9th Cir. 1975), *cert. denied,* 429 U.S. 816 (1976).

person-to-person and omissions of material information accompany that person-to-person transaction.[32]

However, when a person-to-person transaction is not involved, the plaintiff carries the burden of proving reliance. A plaintiff may satisfy this burden by showing actual reliance. That is, the plaintiff must provide competent evidence that he or she actually relied on the misrepresentation. Because it is often difficult to prove actual reliance in the absence of a person-to-person transaction, a plaintiff or a group of plaintiffs will seek to invoke a presumption of reliance to satisfy this element of the claim. In the context of a class action suit, the plaintiffs must often resort to the use of a presumption of reliance so that individual issues of reliance do not predominate over common issues. Indeed, if a presumption is not allowed or is inapplicable, the court would be required to decertify the class because individual issues of fact would predominate, thus rendering the class status untenable.

One presumption available to a plaintiff results from the "fraud-on-the-market" theory . The "fraud-on-the-market" presumption was first delineated in the United States Supreme Court decision *Basic, Inc. v. Levinson*, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988). There, the Court stated that:

> The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the

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[32] Affiliated Ute Citizens of State of Utah v. United States, 406 U.S. 128, 152-54 (1972) reh'g denied, 407 U.S. 916 (1972).

> misstatements. . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such case is no less significant than in a case of direct reliance on misrepresentations.[33]

In approving the theory's presumption, the Supreme Court concluded that "requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented [plaintiffs] from proceeding with a class action, since individualized issues would have overwhelmed the common ones."[34] However, the presumption is not absolute and may be rebutted by a proper showing "that the shares were [not] traded on an efficient market."[35]

In addition to the "fraud-on-the-market" presumption, the United States Supreme Court in *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972), articulated certain circumstances when a plaintiff could invoke the presumption of reliance and/or causation. In *Affiliated Ute*, 85 plaintiffs sought damages under Section lOb and Rule 10b-5, arguing that defendants violated federal law in connection with the sale of securities by the plaintiffs. The Court reversed the circuit court's ruling that no violation occurred since the record revealed no evidence of reliance on material fact misrepresentations by the defendants.[36] The Supreme Court found that only the second subparagraph of Rule 10b-5 requires

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[33] *Basic, Inc.*, at 241-42, 108 S.Ct. at 989 (citing *Peil J. Speiser*, 806 F.2d 1154, 1160-61 (3rd Cir. 1986)).

[34] *Id.*, at 242, 108 S.Ct. at 989.

[35] See, *Id.*, at 248, fn. 27, 108 S.Ct. 992, fn 27.

[36] *Affiliated Ute*, 406 U .S. at 152, 92 S.Ct. at 1471.

evidence of reliance on material fact misrepresentations and that the first and third subparagraphs are not as restrictive.[37] The Court held that even in the absence of actual reliance the defendants' activities fell within the scope of Rule 10b-5.[38]

In conclusion, the *Affiliated Ute* Court pronounced the general presumption that:

> under the circumstances of this case, *involving primarily a failure to disclose*, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in making this decision. [citations omitted]. This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact.[39]

Hence, *Affiliated Ute* stands for the proposition that reliance and/or causation may be presumed in a case where material facts have been withheld or omitted. A withholding of facts, or primarily a failure to disclose, necessarily implies that the case relates mostly to omissions, not to false and misleading statements. Because *Affiliated Ute* dealt primarily with omissions, the presumption articulated there would not apply to a situation where plaintiffs advance theories of recovery based on misrepresentations or a mixed case of misrepresentations and omissions.

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[37] *Id.*, 406 U.S. at 152-53,92 S.Ct. at 1471-472.

[38] *Id.*, 406 U.S. at 153,92 S.Ct. at 1472.

[39] *Id.* , 406 U .S. at 153-54, 92 S.Ct. at 1472 (emphasis added).

Here, because each member of the Plaintiff class did not allege actual reliance, Plaintiffs must rely on a presumption of reliance to prove this element of their Section lOb and Rule 10b-5 claim. The Court finds that Plaintifts allege a mixed case of misstatements and omissions. Nevertheless, Plaintiffs seek to rely on both the "fraud-on-the-market" presumption and the *Affiliated Ute* presumption.

6. Causation/Damages

Loss causation/actual injury is the final element of a Section 1Ob and Rule 10b-5 claim. To satisfy this element a plaintiff must prove a monetary loss and that the monetary loss was directly and proximately caused by the fraud which is alleged to have been committed.[40] The causation requirement is satisfied only if the fraud touches on the reasons for the plaintiff's monetary loss and, even if an investment decision is induced by fraud which is relied on by the plaintiff, recovery under Section lOb and Rule 10b-5 is not permitted if the proximate cause of the monetary loss is other than the fraud alleged.[41]

Plaintiffs allege that they incurred monetary damages as a result of misstatements and omissions with respect to AVBC's financial statements audited by Deloitte. Plaintiffs argue that if they had known the true facts, they would not have purchased AVBC stock, or they would have sold the stock at an earlier date. Thus, Plaintiffs directly attribute their loss to Deloitte's conduct.

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[40] See, *LeVine v. Diamanthuset, Inc.*, 950 F.2d 1478 (9th Cir. 1991).

[41] See, *McGonigle v. Combs*, 968 F.2d 810 (9th Cir. 1992).

Analysis and Discussion

Deloitte seeks summary judgment on Plaintiffs' federal law class claims, arguing that there are no triable issues of material fact with respect to the fifth and sixth elements of the Section lOb and Rule 10b-5 claim. If Deloitte is able to show that there are no genuine issues of material fact as to an essential element of Plaintiffs' class claim, then summary judgment is appropriate.

Reliance Element:

In its motion, Deloitte asserts that Plaintiffs cannot establish the reliance element of the Section lOb and Rule 10b-5 claim. Deloitte advances two main arguments why Plaintiffs' federal law claim must fail. First, Plaintiffs have not alleged and cannot show individual, actual reliance as to each member of the class. Second, Plaintiffs are not entitled to the "fraud-on-the-market" presumption because the market for AVBC shares was not efficient, well-developed and open.

Plaintiffs argue they are entitled to a presumption of reliance based on the "fraud-on-the-market" theory and/or under the Supreme Court decision in *Affiliated Ute*. Plaintiffs argue that *Affiliated Ute* applies because this is an omissions case. Plaintiffs also assert that they have alleged actual reliance on the misstatements made by Deloitte.

The Court has previously determined that this is not primarily an omissions case, thus rendering the *Affiliated Ute* presumption inapplicable to the facts and allegations presented here. Further, the Court finds that while the named Plaintiffs, Albert and Estelle Binder, may have alleged actual, individualized reliance, this allegation is not sufficient for the entire class. Therefore, the question now before the Court is whether the class is entitled to a presumption of reliance based

on the "fraud-on-the-market" theory by virtue of the fact that AVBC common stock traded on an efficient market.[42] This determination is dispositive on Plaintiffs' class claim because if Plaintiffs are unable to prove reliance, the class must be decertified on this cause of action for failure to show individual reliance and because individual issues would overwhelm the common ones.

Deloitte asserts that AVBC stock did not trade on an open, well-developed market. Deloitte characterizes an open and efficient market as follows:

> An open market is one in which anyone, or at least a large number of persons, can buy or sell. A developed market is one which has a relatively high level of activity and frequency, and for which trading information (e.g. price and volume) is widely available. It is principally a secondary market in outstanding securities. It usually, but not necessarily, has continuity and liquidity (the ability to absorb a reasonable amount of trading with relatively small price changes).
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> An efficient market is one which rapidly reflects new information in price.

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[42] The Court's Order of March 31, 1996, (Dkt. #64) discussed the issue of whether AVBC market was sufficiently efficient to invoke the "fraud-on-the-market" presumption. At that time, the Court concluded that based on the complaint, and without the aid of factual discovery , a question of fact existed that required a finding that the Court not dismiss the 10b-5 and lOb claim from the complaint based on Defendants rule 12(b)(6) motion to dismiss. The Court determined that upon the completion of discovery, and upon a proper evidentiary basis, the Court would rule whether the market was efficient.

> These terms are cumulative in the sense that a developed market will almost always be an open one. And an efficient market will almost invariably be a developed one.[43]

The parties do not dispute that AVBC common stock traded over-the-counter ("OTC") through "pink sheets" from at least the beginning of the class period (August 1, 1991) through sometime in December, 1993, when it began trading on the Boston Stock Exchange ("BSE"). Deloitte argues that the OTC market for AVBC stock was not "efficient" and that other courts have found that OTC markets in general are not efficient.[44]

The Court finds an absence of Ninth Circuit case law defining an efficient market necessary to invoke the "fraud-on-the-market" presumption. However, Deloitte points the Court to *Cammer v. Bloom*, 711 F.Supp. 1264, 1286-87 (D.N.J. 1989), which articulates factors a court may consider in determining whether a given market is efficient. Although the Ninth Circuit has not adopted the *Cammer* factors, other district courts in this circuit have applied those factors.[45]

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[43] *Bromberg & Lowenfels, Securities Fraud and Commodities Fraud*, § 8.6 (1988).

[44] See *Epstein v. American Reserve Corp.*, 1988 WL 40500, *5 (N.D.Ill. 1988) (the OTC market "is incapable of meeting the Supreme Court test [of an impersonal, well-developed, efficient market]."); *In Re Data Access Systems Securities Litigation*, 103 F.R.D 130, 138 (D.N.J. 1984) (the trading on the OTC market may not constitute an active and substantial market necessary to apply the fraud-on-the-market theory.).

[45] See, *In re MDC Holdings Securities Litigation*, 754 F.Supp. 785, 804 (S.D. Cal 1990) ("In the absence of Ninth Circuit authority, the court finds that the *Cammer* criteria are

The *Cammer* court found the following factors helpful in determining whether a market for a particular security is efficient:

> (1) a large weekly trading volume; (2) the existence of a significant number of reports by securities analysts; (3) the existence of market makers and arbitrageurs in the security; (4) the eligibility of the company to file an S-3 Registration Statement; and (5) a history of immediate movement of the stock price caused by unexpected corporation events or financial releases.[46]

Deloitte argues that based on the five *Cammer* factors, the market for AVBC stock was not efficient. The Court agrees.

In opposition to Deloitte's motion for summary judgment, Plaintiffs submit the declaration of their expert, Dr. Hekman.[47] Dr. Hekman concludes that "based on all the information available to me, including Deloitte's Experts' Reports, I have no reason to believe that the market price of AVBC stock would not have efficiently reflected the available public information regarding AVBC during the Class Period.[48] Dr. Hekman further opined that "it is my belief and opinion that the OTC market in the United States is, and was during the Class Period, an open,

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helpful in determining whether the market is efficient").

[46] *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990) (citing *Cammer*, 711 F.Supp. at 1286-87 (citing 4 Bromberg & Lowenfels, Securities Fraud and Commodities Fraud § 8.6 (1988)), *appeal dismissed*, 993 F.2d 875 (3rd Cir. 1993).

[47] *See*, Dkt. #296.

[48] Dkt. #296 at 4.

developed, national, impersonal securities trading market."[49] These bare-bones conclusions do not provide the Court with the necessary information to create a genuine issue of disputed fact to support Plaintiffs' allegation that the AVBC trading market was efficient.

In contrast to Plaintiffs' factual presentation, Deloitte provided competent expert opinion by its expert, Dr. Findlay, which demonstrates that there is no genuine issue of material fact as to whether the AVBC market was efficient. First, there is no evidence that AVBC stock enjoyed a large weekly trading volume. In fact, there is no evidence that a public record of trading even existed prior to December, 1993, when the stock began trading on the Boston Stock Exchange. Thus, trading information which would allow for a finding of a large trading volume is nonexistent.

Second, there is no evidence that a significant number of securities analysts' reports were generated regarding AVBC stock. Deloitte's expert failed to find any such reports and Plaintiffs' have submitted no evidence regarding the issue.

Third, although there is some evidence of market makers and arbitrageurs, there is no evidence that the market markers were significant enough to indicate that the AVBC market was efficient. Without more infonnation, however, and even assuming a substantial number of market makers, the Court cannot find as matter of law that this single fact would render the market efficient.

Fourth, there is no evidence that AVBC ever met the eligibility requirements to file an SEC Form S-3. Finally, there is no evidence that AVBC stock price exhibited a history of immediate movement caused by unexpected corporate events or

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[49] *Id.*

financial releases. Another Deloitte expert, Dr. Freeman, submitted expert opinion based on empirical analyses that AVBC stock price did not significantly move in response to news of corporate events or financial releases. In addition, Dr. Findlay concluded that the stock price did not possess the statistical characteristics of an efficient market.

Based on the foregoing analysis, the Court finds as a matter of law that Plaintiffs are not entitled to the "fraud-on-the-market" presumption Similarly, the Court previously held that the Plaintiffs may not rely on the presumption enunciated in *Affiliated Ute*. Because a presumption of reliance is not available, individualized issues of reliance predominate over common ones, thus requiring the Court to decertify the class action until December, 1993, when AVBC shares began trading on the Boston Stock Exchange.

The Court rules as a matter of law that Deloitte has demonstrated an absence of evidence regarding the reliance element of Plaintiffs' Section 1Ob and Rule 10b-5 claim.[50] Moreover, Plaintiffs have not set forth specific facts showing there is a genuine issue of material fact for trial. [51] Therefore, judgment as a matter of law is required on Deloitte's motion as it relates to the efforts by Plaintiffs to maintain a class action under Count One pursuant to Section lOb and Rule 1Ob-5 for the time period August 1, 1991, through the time AVBC stock began trading on the BSE, sometime in December, 1993. However, because Deloitte has not shown, as a matter of law, that the BSE market was inefficient or that that market as it relates to AVBC stock was inefficient, summary judgment is not appropriate based on Deloitte's argument that Plaintiffs cannot rely on the

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[50] See, *Celotex*, 477 U .S. at 325, 106 S.Ct at 2556.

[51] See, *Anderson*, 477 U.S. at 256, 106 S.Ct. at 2439.5

"fraud-on-the-market" presumption for the time period December, 1993, through February 28, 1994.

The Court will next address whether Plaintiffs' Section lOb and Rule 10b-5 claim should be dismissed and the class decertified for the period December, 1993, to the end of the class period, February 28, 1994, under Deloitte's loss causation argument.

Causation/Damage Element:

Deloitte argues that Plaintiffs are unable to prove the element of loss causation/actual damages during the class period. The Court previously concluded that Plaintiffs are not entitled to any presumption of reliance and that the class action must be decertified at least until the time that AVBC stock began trading on the Boston Stock Exchange. For purposes of Deloitte's motion for summary judgment regarding the causation element of the federal claim, the Court need not find that Plaintiffs have failed to prove loss causation for the entire class period, but merely that Plaintiffs cannot prove loss causation for the time AVBC stock traded on the BSE.

Thus, the Court will focus its analysis regarding loss causation for the approximate 90 days that AVBC stock traded on the BSE, approximately December, 1993, until the end of the class period, February 28, 1994.

Essentially, Deloitte asserts that AVBC stock was worth zero throughout the class period and therefore, the financial statements reported on by Deloitte could not have inflated the value of the stock because all the financial statements stated that AVBC had zero net worth. Hence, Deloitte maintains that Plaintiffs would have lost their money under any set of circumstances, even without any of the alleged misrepresentations and omissions. Further, Deloitte asserts that the alleged

misstatements could not have caused Plaintiffs' loss, since AVBC stock steadily decline throughout the class period without regard to corporate announcements or the dissemination of corporate reports and financial statements.

Plaintiffs argue that the Court should presume the element of causation, once again citing *Affiliated Ute*[52] for the proposition that positive proof of causation is unnecessary when materiality is established. Once more, the Court finds that Plaintiffs' reliance on *Affiliated Ute* is misplaced since the Supreme Court held that the circumstances of that case "involv[ed] primarily a failure to disclose."[53] As previously discussed, *Affiliated Ute* dealt with primarily an omissions case, whereas here, Plaintiffs have alleged both omissions and misrepresentations. The Court therefore concludes that Plaintiffs are not entitled to the presumption of causation articulated in *Affiliated Ute*. Plaintiffs assert that to establish a loss causation defense at the summary judgment stage, a defendant must prove, as a matter of law, that the depreciation of the value of the stock resulted from factors other than defendant's false and misleading statements.[54] Plaintiffs maintain that Deloitte cannot meet this showing because the misstatements and omissions depreciated the stock. More specifically, Plaintiffs argue that Deloitte should have provided information in the Financial Statements that AVBC was effectively "out-of-business" and that Deloitte knew that AVBC could not meet its overly optimistic projections and forecasts. Plaintiffs particularly allege that Deloitte should have made the following disclosures: (1) that the product formula was defective; (2) that AVBC was using an additive EDTA which had

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[52] *Affiliated Ute*, 406 U.S. 128,92 S.Ct. 1456.

[53] *Id.*, at 153,92 S.Ct. at 1472.

[54] See, *In Re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1422 (9th Cir. 1994).

not been approved by the FDA; (3) that product containing the EDTA was not selling; (4) that 47 percent of the 1992 product reported as sold was not sold to the public, but rather to Golden Brands, a master distributor; (5) that AVBC owed Golden Brands $500,000 for the repurchase of product; and (6) that Golden Brands wanted out of its distribution agreement and wanted AVBC to repurchase all of its unsold inventory .

The Court finds, and the following discussion will explain, why Plaintiffs have not met their burden at the summary judgment stage showing that Deloitte's alleged misstatements and omissions caused Plaintiffs' loss during the time AVBC stock traded on the BSE. Further, the Court concludes a triable issue of fact does not exist on this issue requiring its submission to a finder of fact.

Deloitte's expert, Dr. Freeman, concludes that, based on statistical testing, the price movement of AVBC stock was unrelated to the public disclosure of any financial statements audited by Deloitte. Plaintiffs contend that the market price of AVBC stock was artificially inflated due to alleged misrepresentations and omission in the audited financial statements and maintain that the stock price was actually zero.

In his report, Dr. Freeman states that since the book value of AVBC was negative and since the company never posted any net earnings, the inflated price of the stock was attributable to some factor other than AVBC's historical financial information as audited by Deloitte.

In fact, Dr. Hekman, Plaintiffs' expert, stated that "virtually all of the market value of AVBC's stock during the Class Period was due to investor expectations regarding the company's prospects, resulting from false and misleading information disseminated into the public trading market for

AVBC's stock and not to the current level of sales, assets or earnings of the Company."

This was the same conclusion reached in a stock valuation report by Wright, Houlihan & Associates in October, 1992. Wright, Houlihan valued a block of stock at $.094 per share. In valuing the stock, Wright, Houlihan stated that "it is our opinion that the market price of this stock does not represent the fair market value of the company [because] . . . the intrinsic value of the company, based on an analysis of its fundamentals, is clearly far less than the value implied by the price of the publicly traded stock." The valuation report provided that "since [AVBC] is not asset based, [an asset approach to valuing the stock] was not used. However, [Wright, Houlihan] did analyze the book value which showed a negative net worth and consequentially, the Company is technically insolvent." The report concluded that "because the Company has current operating losses and history of losses, and negative net worth, public market multipliers based on earnings or book value are meaningless."

This valuation report was disseminated February 11, 1993, almost a full year before the stock began trading on the BSE. Wright, Houlihan concluded that based on the financial statements audited by Deloitte and other financial information provided by the company, the actual value of the stock as well below the price the stock was trading on the market.

Thus, the question becomes what was causing the inflated price. Plaintiffs allege that it was the misrepresentations and omissions regarding the prospects of AVBC. Deloitte contends that it was, among other things, investor attitude spilling over from the new-age beverage industry.

To show that the dissemination of financial statements reported on and audited by Deloitte's did not affect the stock

price of AVBC, Dr. Freeman conducted an "events study". An events study includes trading information (i.e., historical price and volume) along with the publicly disseminated information regarding the company. However, because information regarding sales volume was unavailable, Dr. Freeman had to assume that transactions were made. Dr. Freeman analyzed 30 filings with the SEC and 101 news items discussing AVBC over the class period. He then tested AVBC's price change movements for volatility to determine whether the daily average quote movements were statistically significant.

Of the 54 days where the daily average quote movement was significant, only 11 were on days where there was an information release and none of those 11 days corresponded to a release of an audited financial statement by Deloitte. The testing conducted by Dr. Freeman exhibited that AVBC stock moved in a highly erratic fashion which was usually unconnected with an information release. Interestingly, when there was a correlation between an event and a price movement, it was often in an opposite direction. For example, a positive price movement correlated with the release of negative information.

Deloitte also argues that in order to demonstrate the existence of loss causation, there must be come curative disclosure which deflated the allegedly inflated stock price created by the overly optimistic forecasts and other misrepresentations made in the financial statements. That is, Deloitte asserts that a failure to disclose allegedly "true" facts requires a finding that the stock price was not inflated due to the financial statements, but was due to some other factor because

the stock steadily declined in price in the absence of the disclosure of "true" facts.

The parties do not dispute that only one corrective statement was made by Deloitte throughout the class period. The

1992 year-end Financial Statement was restated March 11, 1993, to report a larger loss for that year based on a revaluation of common stock. Deloitte alleges that the market should have responded adversely to the disclosure and restatement, but in fact reacted positively the day of and the day after the dissemination.[55] Finally, Deloitte maintains that even if AVBC investors relied on Deloitte's reports, nothing in those reports caused Plaintiffs' losses because the financial statements showed AVBC's stock was worth virtually nothing.

In his supplemental report, Dr. Hekman, concludes that "the company's value would have been zero based on a book value calculation; it never reported any net earnings, so that its value based on a multiple of earnings would have been zero; similarly, since AVBC never had any earnings, the growth rate of earnings cannot be used to value the Company."[56] Deloitte cites this statement to show that the stock could not be valued based on the financial statements and that the stock price had to be derived from some other factor which caused the price to inflate, such as unreasonable investor expectations.

Plaintiffs argue that Deloitte has mischaracterized Dr. Hekman' s conclusions because Dr. Hekman found that most, but not all, of the difference in value of AVBC stock was attributable to investor expectations as to future sales and earnings at levels substantially above what was reported in the audited financial statements.

Plaintiffs argue that the misstatements and omissions in the audited financial statements induced investors to pay a higher price for the stock than it was actually worth. However, the Plaintiffs' argument denies logic. The audited financial statements

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[55] *See*, Expert Report of Dr. Freeman.

[56] *Id.* at 5.

clearly show that AVBC was financially unstable. This fact was supported by the Wright, Houlihan valuation report. Plaintiffs cannot tie in the alleged misstatements and/or omission contained in the audited financial statements to their alleged damages Plaintiffs claim for the time period that AVBC stock traded on the BSE.

Finally, there is no genuine issue of material fact the audited financial statements show that AVBC was financially unstable. In this regard, the Court would note the following that appear in the record:

> In the 1990 year end Financial Statement audited by Deloitte, the statement is made that The Company is in the development stage at December 31, 1990. Recovery of the Company's assets is dependant upon future events, the outcome of which is indeterminable. In addition, successful completion of the company's development program and its ultimate attainment of profitable operations is dependant upon obtaining adequate financing to fulfill its development activities and achieving a level of sales adequate to support the Company's cost structure.

The balance sheet shows that liabilities exceed assets, that the company had a net loss and that cash flow was virtually nonexistent.

In the 1991 year end audited Financial Statement, Deloitte again reiterated that the company was in the development stage and that success depended on the ability to meet an adequate level of sales. The balance sheet clearly indicated that liabilities again exceeded assets, that the company realized a net loss for the year and that cash flow was scarce.

The 1992 year end Financial Statement audited by

Deloitte revealed that Deloitte continued to express concern whether AVBC would be able to survive as a going business. Deloitte stated:

> The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company's recurring losses from operations, net stockholders' capital deficiency and negative operating cash flow raise substantial doubt about its ability to continue as a going concern. . . .

Again, the financial statements back up Deloitte's concern that the company was financially unstable, notwithstanding the price that AVBC stock was trading for on the market.

Plaintiffs argue that the Court should look not only to the year-end financial statements, but also to the Quarterly 10-Q Reports which allegedly reported unrealistic projections and made material misstatements and omissions. However, the Court finds no persuasive evidence in the record that Deloitte reviewed or audited those reports.[57] Those reports were the responsibility of AVBC and were in fact signed by corporate officers, not by Deloitte.

The record contains evidence that the stock price of AVBC declined steadily throughout the class period without the impact of curative disclosures. Thus, the Court finds there is no genuine issue of material fact regarding curative statements which affected the stock price. As such, some other factor or factors other than corporate information and disclosures by Deloitte

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[57] The Court finds that Deloitte did audit one 10-Q, a Quarterly Report for the First Quarter of 1993, submitted in conjunction with A VBC's Registration Statement.

caused the stock price to adjust. The record shows that Plaintiffs purchased stock in a poorly capitalized, start-up company and, with the benefit of hindsight, never produced a quality product. The Court finds nothing in the financial statements for the time period December, 1993, through February, 1994, even taking into account the alleged misstatements and omissions which would induce an investor to invest in AVBC stock or induce a current stockholder to retain the stock thereby creating some loss causation through the actions or inactions of Deloitte.

Finally, there are no allegations and no evidence that Deloitte disseminated false and misleading statements or made omissions during the time that AVBC stock traded on the BSE. Plaintiffs do not offer any financial statements or other reports audited by Deloitte for the year-end 1993 or during 1994. This fact alone would require the Court to find that Plaintiffs cannot show that Deloitte's conduct inflated AVBC stock price during the time the stock traded on the BSE. Because no reports were audited or issued by Deloitte during that time, no false statement or omission could have occurred which resulted or caused Plaintiffs' loss.

Based on the foregoing analysis and discussion, the Court concludes as a matter of law that Plaintiffs have not show a triable issue of material fact that Deloitte's conduct caused the loss or damage during the time AVBC stock traded on the BSE. Deloitte provided competent evidence which was not countered by Plaintiffs. Thus, the Court will grant Deloitte's motion for summary judgment on the element of causation/damages for the time period that AVBC stock traded on the BSE.

The financial statements audited by Deloitte clearly show the company had no cash flow, no earnings, and that the cpmpany's prospects, notwithstanding Plaintiffs allegation to the contrary, did not support the value attached to the stock being

traded on the market. Plaintiffs have failed to show that the monetary loss was directly and proximately caused by the fraud which is alleged to have been committed.[58] Plaintiffs have likewise failed to prove that the alleged fraud touches on the reasons for the plaintiff's monetary loss and that the proximate cause of the monetary loss is not from another factor.[59]

2. **Plaintiffs' Motion for Summary Judgment Against Deloitte**

Plaintiffs move for summary judgment (Dkt. #269-1) or partial summary adjudication (Dkt. #269-2) against Deloitte in three distinct areas. First, Plaintiffs assert that Deloitte failed to comply with Accounting Principles Board (" APB") Opinion 25 in its audited 1992 Financial Statement regarding the issuance of approximately 2.1 million shares of AVBC stock. Second, Plaintiffs assert that Deloitte failed to report a corporate liability in the amount of $678,589 in its audited 1991 Financial Statement, instead characterizing the amount as a gift, or contribution to capital. Finally, Plaintiffs assert that Deloitte failed to comply with APB 25 in its audited 1991 Financial Statement regarding the issuance of approximately 2.5 million shares of AVBC stock.

Plaintiffs maintain that by finding summary judgment is appropriate as to these three instances of alleged conduct, that conclusion will require a finding of liability against Deloitte on Plaintiffs' federal law securities claim based on Rule 10b-5 and Plaintiffs' state law claims for negligence, negligent misrepresentation and constructive fraud.

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[58] See, *Levine v. Diamanthuset, Inc.*, 950 F.2d 1478 (9th Cir. 1991).

[59] See, *McGonigle v. Combs*, 968 F.2d 810 (9th Cir. 1992).

Regarding the 1992 Financial Statement and the alleged issuance of 2.5 million shares of AVBC stock to corporate personnel and the 1991 Financial Statement and the alleged inappropriate valuation of 2.1 million shares of stock, Plaintiffs assert that Deloitte was at the very least negligent because these transactions were not performed in compliance with GAAP and/or GAAS. Further, Plaintiffs argue that because Deloitte restated and reissued the 1992 Financial Statement, this conclusively establishes that Deloitte was per se negligent. These actions, Plaintiffs state, show the materiality of the misstatements, thus implicating the presumption of reliance and causation for the Rule 10b-5 claim.

In response, Deloitte argues that the stock valuation irl the 1992 Financial Statement was not misleading since the valuation was provided in the 1992 10-K report. Further, Deloitte asserts that violations of GAAS and/or GAAP do not support a finding of intent to defraud or scienter.[60] Plaintiffs argue that the three alleged misrepresentations are material. That is, Plaintiffs assert that a reasonable person would attach importance to the misstatements in determining his choice of action in the

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[60] See, *In Re Software Toolworks*, 50 F.3d 615, 628 (9th Cir. 1994) (scienter requires more than a misapplication of aecounting principles, the plaintiff must prove that the accounting practices were so deficient that the audit amounted to no audit at all.); *In Re Worlds of Wonder Securities Litigation*, 35 F .3d 1407, 1426) (the mere publication of inaccurate accounting figures, or a failure to follow GAAP , without more, does not establish scienter); *The Limited Inc. v. McCrory Corp.*, 645 F.Supp. 1038, 1045 (S.D.N.Y. 1986) (errors in a client's financial statements do not give rise to an inference of fraud on the part of the auditor).

transaction.[61] At this point, the Court will reiterate that materiality is usually a jury question because it requires an assessment of the inferences that a reasonable shareholder would draw from a given set of facts.[62]

Based on the record before the Court, the Court finds that the three transactions complained of by Plaintiffs raise a genuine issue of material fact requiring a determination of materiality by the finder of fact. Because the Court concludes that a material fact exists, summary judgment is inappropriate.

3. Wilson Defendants Motion for Summary Judgment Against Plaintiffs

Defendants Wilson, Sim, Stevens and Fitchey, the "Wilson Defendants," move for summary judgment (Dkt. #248) regarding Plaintiffs' federal and state claims. As to the federal claims, the Wilson Defendants argue summary judgment is warranted because Plaintiffs cannot prove the essential element of reliance. Based on the Court's previous finding that both the "fraud-on-the-market" presumption and the *Affiliated Ute* presumption are unavailable, and that Plaintiffs are unable to prove the necessary elements of reliance and causation/damages, the Court concludes that summary judgment is appropriate for the

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[61] *TSC Industries v. Northway, Inc* , 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976); *Admiralty Fund v. Hugh Johnson & Co.* , *677 F.2d* 1301, 1306 (9th Cir. 1982) (citing *Northwest Paper Corp. v. Thompson*, 421 F.2d 137, 138 (9th Cir. 1969)); *SEC v. Murphy*, 626 F.2d 633, 643 (9th Cir. 1980).

[62] *Price Co v. Fecht*, 70 F.3d 1078, 1080 (9th Cir. 1995), *cert. denied*, _____U.S._____, 116 S.Ct. 1422, 134 L.Ed.2d 547 (1996); *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir. 1985).

Wilson Defendants regarding Plaintiffs' class cause of action under Section lOb and Rule 10b-5.

The Wilson Defendants also argue that summary judgment is required for certain state law claims. However, the Court need not reach the merits of Plaintiffs' causes of action based on state law because the Court will decline to exercise supplemental jurisdiction over those class claims. Under 28 U.S.C. § 1367, in certain circumstances a court may decline to exercise supplemental jurisdiction over a claim brought in a civil action of which the court has original jurisdiction. That section provides in pertinent part (a) Except as provided in subsections (b) and (c) or as expressly provided otherwise by Federal statute, in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy. . .

(c) The district courts may decline to exercise supplemental jurisdiction over a claim under subsection (a) if --

(1) the claim raises a novel or complex issue of State law,

(2) the claim substantially predominates over the claim or claims over which the district court has original jurisdiction,

(3) the district court has dismissed all claims over which it has original jurisdiction,or

(4) in exceptional circumstances, there are other compelling reasons for declining jurisdiction.[63]

Above, the Court determined that Plaintiffs' cause of action for federal securities law violations must be decertified for the inability to prove certain essential elements of that claim.

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[63] 28 U.S.C. § 1367(a),(c).

Pursuant to 28 U.S.C. § 1367, the Court will decline to exercise supplemental jurisdiction by the class over the remaining state law claims against Deloitte and the Wilson Defendants because the Court has "dismissed all [class] claims over which the [Court has] original jurisdiction."[64] Therefore, the Court will not exercise supplemental jurisdiction by the class ove

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

ALBERT AND ESTELLE BINDER,
in their individual capacities
and on behalf of one or more classes
of persons similarly situated,
Plaintiffs

v.

THOMAS GILLESPIE, MARIE MULLEN GILLESPIE,
IAN R. WILSON, T. GORDON SIM, DIANE L. KARBAN,
DIANE KARBAN BARKER, CARY S. FITCHEY,
LEE STRADER, JOHN A. GOOD, ROBERT BAHOSHY,
MARK L. STEVENS, AQUA VIE BEVERAGE
CORPORATION AND DELOITTE & TOUCHE
Defendants

Case No. 94-0528-S-MHW

FIRST AMENDED CLASS ACTION COMPLAINT FOR NEGLIGENCE; BREACH OF FIDUCIARY DUTY; NEGLIGENT MISREPRESENTATION; CONSTRUCTIVE FRAUD; FRAUD; AND FEDERAL AND STATE SECURITIES FRAUD

(Demand For Jury Trial)

FILED DECEMBER 10, 1996
CLERK, U.S. DISTRICT COURT
DISTRICT OF IDAHO

THE PLAINTIFFS, AND EACH OF THEM, HEREBY STATE AND ALLEGE AS THEIR FIRST AMENDED COMPLAINT, THE FOLLOWING:

I.

INTRODUCTION AND GENERAL ALLEGATIONS

1. During the period August 1, 1991 through February 28, 1994 Aqua Vie Beverage Corporation (herein "AVBC" or the "Company") made fraudulent and false and misleading public representations, statements and assurances affecting the offer, sale, purchase and trading in the securities of AVBC. AVBC's wrongful and actionable conduct was caused by certain officers and directors of such Company named as defendants in this action including Thomas J. Gillespie, Marie Mullen Gillespie, Ian R. Wilson, T. Gordon Sim, Diana L. Karban and Diane Karban Barker, Cary S. Fitchey, Lee Strader, John A. Good, Robert Bahoshy and Mark L. Stevens (herein collectively "Management") who, themselves, were the ones who made and caused the Company to make such fraudulent and false and misleading statements. All of the Defendants named as AVBC Management in this First Amended Complaint (herein the "Complaint") were officers and directors of AVBC or acting in capacities similar thereto and, as such, owed fiduciary duties to the Plaintiffs and all of the other shareholders of the Company. AVBC's outside accountant, auditor and financial consultant Deloitte & Touche participated with and knowingly assisted AVBC's Management in making certain of such fraudulent and false and misleading statements and issued false and misleading statements and reports on AVBC's audited financial statements. As AVBC's outside accountant and independent auditor, Deloitte owed fiduciary and other similar special duties to, and was in a special relationship with, the Plaintiffs and all of the Company's other securities holders. During the period covered

by this Complaint, the Defendants knowingly and intentionally made false and misleading statements concerning the business, financial condition, prospects and other matters pertaining to AVBC so as to inflate the price of AVBC stock in the public trading market for such stock including, without limitation, as follows. AVBC Management touted the prospects for the Company's non-carbonated "lightly flavored" bottled water product line but failed to disclose that the Company had done only limited consumer taste testing of the product which test results indicated that the taste of the Company's product line was "unsatisfactory" to consumers. The Company also failed to disclose that, at the time the Company started manufacturing its product for sale to the public, its formulae for the product was defective and that, shortly after the bottling of such product, it would discolor in the bottle and turn "brown" rendering it unsaleable. Even though the Company's Management was aware of such product defect, the Company went forward with commercial production of the product with the result that a substantial majority of such product turned brown, was unsaleable and had to be repurchased by the Company. Thereafter, the Company tried using an additive ("EDTA"), which was not approved by the U.S. Food and Drug Administration ("FDA"), in the product to prevent the product from discoloring in the bottle. The use of EDTA in the Company's product was in violation of applicable FDA rules and regulations; and, in any event, did not prevent discoloration of the Company's product beyond a six months period of time. The Company promised its distributors that the Company's product had a "shelf-life" of at least twelve months, exposing the Company to further breach of warranty claims by such distributors. The Company made repeated public announcements regarding the distribution of its products through independent distributors throughout the United States, but failed to disclose that, in addition to having the right to return and force the Company to repurchase the Company's defective product, such distributors had the right to return and

be reimbursed by AVBC for any product which the distributors purchased from the Company but could not sell; and without disclosing that all of the distributors that the Company had previously announced had agreed to distribute the Company's products had subsequently resigned and returned their inventory of the Company's products for re-purchase by the Company (eliminating virtually all of the Company's previously reported sales). The Company announced national distribution of its product line, but failed to disclose that as a result of the resignation of all of the Company's previously announced distributors actual sales of the Company's bottled water products was limited to only two cities in the United States and that sales in such two states were next to nothing. The Company announced publicly that the three largest grocery store chains in California had entered into agreements to sell the Company's bottled water products. No such agreements ever actually existed. The Company issued projections for future sales of the Company's products without any reasonable basis for such projections. For example, in August of 1991 the Company stated that sales in the next twelve months were expected to exceed $19 million. Actual sales for the period October 1991 - September 1992 were less than $1.5 million (and such reported sales were subject to adjustment for return of defective product and otherwise in accordance with the return provision set forth in the Company's agreements with distributors). Beginning in 1991 and continuing through 1993, the Company issued repeated assurances that annual sales revenue would be approximately $20 million for 1992 and $50 million for 1993, and that the Company would be profitable. During the three years ended December 31, 1993, the Company's total cumulative sales revenue, as reported by the Company, was less than $2.5 million; and the Company's total cumulative losses substantially exceeded $12 million. Since sales of the Company's product were almost non-existent in the 1st Quarter of 1993, Management caused AVBC to fabricate and report

sales of approximately $650,000 for such period (which was approximately 85% of reported sales for the period) which sales never took place or otherwise existed. Later, in the 4th Quarter of 1993, Management subsequently "reversed" such fictitious sales through undisclosed accounting adjustments. Deloitte & Touche, which regularity reviewed and commented on the Company's unaudited quarterly financial statements, was aware, or was extremely reckless in not knowing, that the Company's Management was causing AVBC to record and report fictitious sales (sales that never took place). Deloitte was also aware that the Company was reporting in its audited year-end financial statements for 1991 and 1992, approximately $680,000 in monies advanced to the Company by a shareholder (Frank Lopez) as a "contribution to capital" instead of properly reflecting and reporting such advance and resulting obligation as a liability. The understating of this and other liabilities on the Company's audited financial statements, rendering them fraudulent and otherwise false and misleading, was designed and intended to cover-up and conceal, among other things, the fact that the Company was insolvent and could not pay its obligations as they came due. In the period covered by the Complaint, the Company assured shareholders and investors that the gross profit margin on the Company's products (sales revenue less cost of goods sold) would be 75% but, in actuality, the Company's gross profit margin never exceeded 37.5%. The Company announced agreements for the sale of securities, the proceeds of which it said would qualify the Company for listing on NASDAQ when, in fact, the Company had not sold such securities and did not have agreements for the sale of such securities and the Company did not meet NASDAQ's listing requirements. The Company failed to report or otherwise disclose expenses associated with the issuance of stock by the Company to Management, then later recorded and reported such expense in a manner designed and intended to cover-up and conceal the fact that the Company had not been able to actually sell newly issued stock

as previously announced. The Company's audited and unaudited financial statements failed to report or otherwise disclose that the Company's Chief Executive Officer, Thomas J. Gillespie, had caused the Company to assume and pay his personal obligation and debt for the purchase of shares of the Company's stock by him from prior shareholders of the Company and that he had caused the Company to issue millions of shares of its stock to him without payment of any consideration by him for the sale and issuance of such stock. The Company also failed to report or otherwise disclose that Tom Gillespie had previously been found to have committed bankruptcy fraud, was a convicted felon and that the Company had previously been ordered to cease and desist selling bottled water products in the State of Hawaii (due to contamination found in such product representing a serious health risk to consumers who purchased and consumed such bottled water product).

2. As a result of such false and misleading statements designed and intended to inflate the value of the Company's stock, during the period covered by this Complaint trading in the Company's Common Stock increased approximately 400% rising as high as $5.50 per share. At the date of the filing of the Complaint in this action, and continuing to date, the Company's stock and other securities were worthless. As a result of the Company's false and misleading statements, in September of 1991 the Plaintiffs purchased a total of 3,000 shares of the Company's Common Stock at approximately $4 per share for a total purchase price of $12,245, and later sold such stock in December of 1993 at approximately $1 per share with a resulting loss of almost $10,000.

II.

JURISDICTION

3. This Court has exclusive jurisdiction over the federal securities law claims set forth in this Complaint under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 77a et seq. and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (herein the "1934 Act" or the "Securities Exchange Act").

4. Venue in this Court is proper because the defendants transacted business in, can be found in and caused the transfer of this action to the District of Idaho. Venue was also proper in the Central District of California where this action was initialed filed. 15 U.S.C. § 77aa; 18 U.S.C. § 1965.

III.

PLAINTIFFS

5. At the time of the filing of this action, Albert and Estelle Binder were individuals residing in the state of Maryland (herein collectively referred to as "Binder" or the "Plaintiffs"). Subsequent to the filing of this action, Estelle Binder died, and Albert Binder succeeded to 100% ownership of the shares of AVBC stock previously owned by him and his wife.

6. In addition to their individual claims as set forth in this Complaint, the Plaintiffs through this action seek to represent the interests of all persons similarly situated as more fully set forth under "Class Action Allegations" which follows as Section V of this Complaint.

7. The Plaintiffs first became aware of the facts giving rise to their claims as set forth in this Complaint less than one year prior to the filing of such Complaint.

8. In determining to purchase the Company's Common Stock, the Plaintiffs relied upon the integrity of the public trading market for such securities.

IV.

DEFENDANTS

9. Thomas J. Gillespie ("Gillespie") was, during all times relevant to the allegations set forth in this Complaint, the Chairman of the Board of Directors of AVBC and prior to January 1994 Gillespie served as President and Chief Executive Officer of the Company. Gillespie is the largest single shareholder of AVBC; and Gillespie, individually and collectively with his wife Marie Mullen Gillespie, is one of the "controlling persons" of AVBC as that phrase is defined under Section 20 of the Securities Exchange Act (15 U.S.C. § 78t), and Section 25504 of the California Corporate Securities Law of 1968 ("CSL"). Prior to the acquisition of KWC, Inc. ("KWC") by the Company in January of 1991, Gillespie served as the founder, director and president of KWC. Gillespie signed all of the Company's periodic (monthly, quarterly and annual) reports to and as required by the United States Securities and Exchange Commission ("SEC") during the period from August 1, 1991 through February 28, 1994, which reports to the SEC and each of them were materially false and misleading. For instance, in its Quarterly Report to the SEC on Form 10-Q for the three months ended March 31, 1991 filed with the SEC on or about August 23, 1991, the Company made the following statement: "Notes payable [$81,638] at March 31, 1991 are payable to former shareholders of KWC, Inc. . . " Such statement was false and misleading because

Gillespie (assisted by Karban and Deloitte & Touche which accounting firm purported to act as AVBC's independent auditors) had caused AVBC to assume and pay his personal obligation and debt incurred as a result of the purchase of the Company's securities by Gillespie from several former shareholders of the Company (KWC, Inc.). Such note payable was not really an obligation of the Company, it was Gillespie's personal obligation. Gillespie was also responsible for AVBC's press release published and publicly disseminated on or about March 30, 1993 wherein AVBC announced that it had met NASDAQ's asset and capital requirements by recording stock subscriptions receivable related to the sale of the Company's Common Stock in what the Company described as a Regulation "S" (offshore) offering. Such statement was false and misleading because, in accordance with SEC Rule 5-02.30 of Regulation S-X, stock subscriptions receivable cannot be considered as "equity" for financial reporting purposes until such subscriptions are collected. AVBC had not sold and never did sell the stock which was the subject of such press release; and the Company did not then and never did meet NASDAQ's assets and capital listing requirements. Although Gillespie was discovered, and subsequently admitted, to have been engaged in "insider trading" in the Company's Common Stock in January of 1993, no report or disclosure of such insider trading under Section 16(b) of the Securities Exchange Act by Gillespie was ever made or issued by Gillespie or the Company.

10. Marie Mullen Gillespie ("Mullen") is Senior Vice President - Design and a Director of AVBC and prior thereto was Vice President of Sales of KWC. Mullen is the wife of Thomas J. Gillespie. As a result of her status as an officer/director of AVBC, her marital relationship with Gillespie, and the shares of AVBC stock owned by such persons, Mullen is one of the "controlling persons" of AVBC as that phrase is defined under Section 20 of the Securities

Exchange Act and Section 25504 of the CSL. During the August 1, 1991 through February 28, 1994 period covered by this Complaint, Mullen knowingly and intentionally made and caused the Company to make materially false and misleading public statements regarding the business, financial condition, prospects and affairs of AVBC. Mullen signed AVBC's Annual Reports to the SEC for the years ended and as at December 31, 1991 and 1992 which contained materially false and misleading statements, including AVBC's 1992 10-K Report which understated AVBC's stock compensation awards to employees (including to Gillespie and Mullen) by approximately $3 million, thus materially understating AVBC's loss and overstating AVBC's stockholders' equity for the year ended and as at December 31, 1992. Mullen also signed AVBC's Form S-1 Registration Statement under the Securities Act of 1933 (herein "AVBC's S-1") which was declared effective by the SEC on February 16, 1993 and which incorporated the Company's audited financial statements for the year ended and as at December 31, 1991 and 1992.

11. Beginning in September of 1992 and thereafter at all relevant times covered by this Complaint, Ian R. Wilson ("Wilson") was a director of AVBC. As a member of the Board of Directors of AVBC, Wilson approved and authorized the filing and public dissemination of numerous SEC reports, including but not limited to AVBC's Annual Report to the SEC on Form 10-K for the year ended December 31, 1992, AVBC's Annual Report to Stockholders for the year ended December 31, 1992, AVBC's S-1, AVBC's Proxy Statement dated October 1, 1993 (herein "AVBC's Proxy Statement") and numerous press releases regarding the business, financial condition, prospects and affairs of AVBC which he knew contained materially false and misleading statements because Mr. Wilson knew at the time that the Company's agreements with distributors provided them with the right to unilaterally terminate such agreements and to

return for re-purchase by the Company all of the distributor's unsold inventory of the Company's products. Mr. Wilson also knew that the Company had done virtually no consumer taste (including "Bamboo", "Paradise", "Avalanche", "Java" and "Harvest" flavors) or other testing of its products and that the little testing which had been done indicated that the Company's products were not being well received by test consumers. Accordingly, Mr. Wilson knew that there was no factual basis for the Company's extremely aggressive projections of sales revenue and earnings. Throughout the period covered by this Complaint, the Company never once withdrew or corrected any of its sales/earnings projections which were either false or misleading when made or, with the passage of time, subsequently became false or misleading. (See Section VI, Fraudulent And False And Misleading Statements). Wilson signed and caused the Company to file AVBC's Annual Report to the SEC on Form 10-K for the year ended and as at December 31, 1992 (which understated AVBC's stock compensation awards to employees by $3 million and reflected the Gillespie debt assumed by AVBC) and AVBC's S-1 which incorporated the Company's audited financial statements for 1991 and 1992. The Company's 1992 10-K Report, including audited financial statements included therein, also failed to report or otherwise disclose the Company's obligation and liability to Frank Lopez for monies previously advanced by such stockholder to the Company in 1991; and such 10-K Report did not report or otherwise disclose the Company's liability to the Company's distributors in respect of the repurchase by the Company of defective and other product previously sold by the Company to such distributors. As a director of the Company, Defendant Wilson owed fiduciary and other special duties to the Company and to its securities holders including the Plaintiffs and the Class including to oversee and supervise the Company's Management and the reporting by such Management to the Company's securities holders and other public investors.

Following the time that Defendant Wilson knew, or was extremely reckless and negligent in not knowing, that Thomas Gillespie and other members of the Company's Management, were causing the Company to issue and publicly disseminate false and misleading financial statements and other securities disclosure information, Defendant Wilson took no action to attempt to remedy and correct such situation and thereby knowingly and intentionally allowed such wrongful activity and conduct to continue, and participated in the issuance and dissemination of false and misleading statements regarding the Company, to the further detriment and damage to the Plaintiffs and the Class.

12. T. Gordon Sim ("Sim") became Executive Vice President and a Director of AVBC in September of 1992. Prior to such date and beginning in approximately July 1991, Mr. Sim was a special advisor to Gillespie and to AVBC acting as a quasi officer/director of the Company, and providing services to AVBC which included, among other things, executive level advice and assistance (1) in designing and establishing a distribution system for AVBC's products, (2) establishing financial relationships for AVBC (3) participating and assisting AVBC with investor relations and other external corporate communication matters, and (4) participating in the decision to begin commercial production of the Company's product knowing that the formulae for the product was defective and that the Company's bottled water product would turn brown, and otherwise be unsaleable, a short time after it was produced. Beginning in September 1991, Defendant Sim was part of, and acted as part of, the Company's senior Management group with the internal title and position, together with Thomas Gillespie, of "Office of the President" and making executive level decisions about the Company's business, financial affairs and securities disclosure matters. In the Summer of 1992, Defendant Sim was aware that the Company's product was defective and,

together with Thomas Gillespie, he authorized and approved the use of EDTA in the Company's product, in an effort to correct the problem that caused the Company's water product to turn brown shortly after bottling, knowing however that EDTA was not an FDA approved ingredient in non-carbonated, plastic bottled water products manufactured for sale and consumption in the United States. Plaintiffs are informed and believe that as part of the Company's "Office of the President", Defendant Sim participated in the preparation of AVBC press releases and other securities disclosure communications (including, on information and belief, sales and other revenue and earnings related projections) issued and otherwise disseminated by AVBC even prior to September of 1991, which as alleged elsewhere, were false and misleading. Prior to the purchase of AVBC stock by the Plaintiffs in July of 1991, Defendant Sim participated and otherwise assisted in the preparation of that certain AVBC Press Release dated July 26, 1991 announcing that he was joining AVBC, effective July 30, 1991, to assist with current operational challenges facing AVBC and to assist in formulating and implementing the Company's overall strategy for growth. Sim, on information and belief as alleged herein, participated and assisted AVBC in the preparation and dissemination of false and misleading statements regarding the Company's prospects for and assurances of success commencing as early as July 1991, and thereafter until February of 1993. In light of his executive level status at the Company, including level of compensation and stock ownership, both prior to and after September 30, 1992, Defendant Sim acted as should be deemed to be part of AVBC's internal executive management group responsible for AVBC management's public statements, SEC filings and other communications to stockholders. Mr. Sim was formerly a Vice President and Director of Clearly Canadian Beverage Corporation ("Clearly Canadian"). During his tenure as a consultant and quasi officer/director of AVBC and thereafter as an officer/director of AVBC, Sim approved and caused the

filing and public dissemination of numerous reports to the SEC, including but not limited to AVBC's Annual Report to the SEC on Form 10-K for the year ended December 31, 1992, AVBC's Annual Report to Stockholders for the year ended December 31, 1992, AVBC's S-1, AVBC's Proxy Statement and numerous press releases regarding the business, financial condition, prospects and affairs of AVBC which he knew were materially false and misleading which, as alleged elsewhere in this Complaint, were false and misleading. The Company's 1992 10-K Report, including audited financial statements included therein, also failed to report or otherwise disclose the Company's obligation and liability to Frank Lopez for monies previously advanced by such stockholder to the Company in 1991; and such 10-K Report did not report or otherwise disclose the Company's liability to the Company's distributors in respect of the repurchase by the Company of defective and other product previously sold by the Company to such distributors. (See Section VI, Fraudulent And False And Misleading Statements). As a Director of the Company, Defendant Sim owed fiduciary and other special duties to the Company and to its securities holders including the Plaintiffs and the Class including to oversee and supervise the Company's Management and the reporting by such Management to the Company's securities holders and other public investors. Following the time that Defendant Sim knew, or was extremely reckless and negligent in not knowing, that Thomas Gillespie and other members of the Company's Management, were causing the Company to issue and publicly disseminate false and misleading financial statements and other securities disclosure information, Defendant Sim took no action to attempt to remedy and correct such situation and thereby knowingly and intentionally allowed such wrongful activity and conduct to continue, and participated in the issuance and dissemination of false and misleading statements regarding the Company, to the further detriment and damage to the Plaintiffs and the Class. At the time that Sim became a special advisor

to Gillespie and the Company, or shortly thereafter, he received a grant of 200,000 shares of AVBC Common Stock; and, subsequently, Sim received an additional grant or other allocation of 800,000 shares of AVBC stock bringing Sim's total ownership in AVBC to one million shares. However, some or all of such shares were held in the name of Gillespie to conceal Mr. Sim's ownership of such shares until sometime after December of 1991 when such shares were transferred to a Canadian entity owned or controlled by Sim. On February 12, 1993, Sim resigned his position as a Director and senior executive officer of AVBC in the face of an SEC investigation for alleged illegal insider trading by Sim in the stock of Clearly Canadian. The fact of and reason for Sim's resignation as an officer of the Company was never publicly reported or otherwise disclosed by the Company. Sim signed AVBC's S-1, which incorporated AVBC's audited financial statements for the years ended and as at December 31, 1991 and 1992 and which failed to properly report his ownership of 1,000,000 shares of the Company's Common Stock issued in Gillespie's name.

13. During all or substantially all of the period relevant to the allegations of the Complaint, Diane L. Karban and Diane Karban Barker following her marriage in 1993 ("Karban") was a senior executive officer of the Company holding the title and/or performing the duties of Vice President - Finance and Controller of AVBC. Prior to January 8, 1991, Defendant Karban was an employee of and/or a consultant to Gillespie and KWC before KWC was acquired by the Company. When the Company hired Jay King as the Company's Controller in 1992, Defendant Karban initiated and thereafter participated in such employment decision; and, at all times when Defendant Karban was employed by the Company, she was Jay King's immediate supervisor. Defendant Karban was the person at the Company who was primarily responsible, with Deloitte's assistance and advice, for the actual preparation

of the Company's audited year-end and unaudited quarterly financial statements which are the subject of this Complaint. Defendant Karban, who is a Certified Public Accountant, also prepared KWC's financial statements dated October 31, 1990 which were used by Gillespie to effectuate the acquisition of KWC by the Company in January of 1991. Such KWC financial statements were materially false and misleading. In her capacity as Vice President - Finance and Controller of AVBC, Defendant Karban prepared and/or assisted in the preparation of and caused the filing and public dissemination of numerous reports to the SEC, including but not limited to AVBC's Quarterly Report to the SEC on Form 10-Q for the three months ended March 31, 1991 and all succeeding Quarterly Reports to the SEC through and including at least September 30, 1993, AVBC's Annual Reports to the SEC on Form 10-K for the years ended December 31, 1991 and 1992, AVBC's Annual Report to Stockholders for the years ended December 31, 1991 and 1992 and AVBC's S-1 which Defendant Karban knew contained materially false and misleading statements. Defendant Karban also prepared and participated in the preparation and public dissemination of AVBC's Proxy Statement dated October 1, 1993 and numerous press releases regarding the business, financial condition, prospects and affairs of AVBC which she knew contained false and misleading statements. (See Section VI, Fraudulent And False And Misleading Statements). In March of 1992, Defendant Karban authored, signed and caused to be publicly disseminated a "Dear Investor" letter which served as a cover or transmittal letter for the Company's "Annual Report" (the Company's Annual Report to the SEC on Form 10-K for the year ended December 31, 1991) which report was provided to shareholders and prospective investors and was otherwise publicly disseminated. Such letter stated that "consumer response to our product testing has been very positive" and "we are confident that 1992 will bring continued success to Aqua Vie". AVBC's Form 10-K which accompanied

Defendant Karban's letter failed to disclose that Gillespie (aided and assisted by Karban and Deloitte) had caused AVBC to assume Gillespie's personal debt and obligation in the approximate amount of $81,638 and that Gillespie had overstated his ownership of AVBC Common Stock by a minimum of 240,000 shares which shares were actually owned by three other shareholders of the Company (Wally and Helen Morgus and Janet Drake Morris), not by Gillespie. Karban signed AVBC's S-1 which incorporated AVBC's 1991 and 1992 audited financial statements and Defendant Karban prepared and participated in the preparation of AVBC's press releases, and was identified as the "person to contact" in respect of the subject matter of such press releases, during the period covered by this Complaint, including the Company's December 14, 1992 press release reporting that the proceeds from subscriptions to purchase $4 million of the Company's Common Stock in the Company's Regulation "S" (offshore) offering would "enable the Company to complete standard quantitative NASDAQ listing requirements" and that AVBC anticipated national distribution of its product line by the end of 1992 which Defendant Karban knew were materially false and misleading statements because at the time Defendant Karban knew that the Company needed more than $4 million to meet NASDAQ's listing requirements. In 1991, Defendant Karban knew that the Company was receiving monies advanced by a shareholder of the Company named Frank Lopez, totalling approximately $680,00, but that no liability in respect of such advance was recorded by the Company on its financial books and records or reported by the Company in its audited or unaudited financial statements including as audited and reported upon by Deloitte & Touche for the years ended December 31, 1991 and 1992 (or as a "subsequent event" in the footnotes to the Company's 1990 audited financial statements issued by the Company and reported upon by Deloitte after the time that a substantial portion of such monies had already been received by the Company). Defendant

Karban participated in the preparation of the Company's audited 1991 year-end financial statements which reflected and reported the grant and issuance of 2,500,000 shares of the Company's Common Stock to her, and to Thomas and Marie Gillespie as the Company's "Entrepreneurial Team", without the payment of any consideration for the purported sale and issuance of such stock in January of 1991 (before the Company's stock began trading in any public market for such stock), knowing that such stock issuance was not authorized in February or at any other time in 1991 and did not actually take place until March or April of 1992 when such Entrepreneurial Team falsified and back-dated corporate minutes and resolutions falsely reflecting that such stock had been authorized for issuance in January of 1991 (when there was no recognized trading market price for such stock allowing such Defendants to thereby dramatically understate the expense attributable to the issuance of such "free stock" by the Company to such Entrepreneurial Team including Defendant Karban). Karban also knowingly participated in the preparation and issuance of the Company's 1st Quarter 10-Q Report to the SEC for the three months ended March 31, 1993, including the unaudited financial statements included therein and otherwise publicly disseminated by the Company, which financial statements and Report reflected and otherwise reported fictitious sales of the Company's product (sales that Karban knew had not actually taken place and never did take place) in excess of $650,000. Although Defendant Karban was known to have engaged in "insider trading" in the Company's Common Stock including without limitation in January of 1993, no report or disclosure of such insider trading under Section 16(b) and/or Section 10(b) of the Securities Exchange Act by Karban was ever made or issued by the Company or anyone else for and on behalf of the Company.

14. Cary S. Fitchey ("Fitchey") was announced as the Chief Operating Officer of AVBC in January

1994. Prior to such formal designation as a senior executive officer of the Company and the announcement thereof, Defendant Fitchey purported to act as a special executive level "consultant" to AVBC and Gillespie, but acted in the capacity of and performed services similar to those of an officer/director of the Company. Defendant Fitchey was, at all times from and after Defendant Wilson's association with the Company, Mr. Wilson's designated representative and agent for AVBC business; and he acted, and was recognized by the Company's Management to be acting, in such capacity. Mr. Fitchey joined AVBC in June of 1992 in such "consulting" position and was thereafter involved substantially full-time in the preparation of projections, business plans and fund raising efforts for AVBC. Mr. Fitchey attended all or substantially all of AVBC's Board Meetings; and he prepared and participated in the preparation of AVBC's press releases. Mr. Fitchey prepared and assisted in the preparation and public dissemination of numerous securities disclosure documents by the Company, including but not limited to AVBC's Regulation "S" (purportedly offshore offering) Investment Memorandum covering the offer and sale of up to 3,500,000 shares of AVBC's Common Stock at $2.125 per share, AVBC's S-1 covering the offer and sale of 2,000,000 shares of AVBC's Common Stock at $5.35 per share and AVBC's Offering Circular/Prospectus covering the offer and sale of the Company's 5% Convertible Subordinated Debentures due December 31, 1994, as well as numerous press releases and financial forecasts/projections regarding the business, prospects and affairs of AVBC which he knew contained materially false and misleading statements. The foregoing Investment Memorandum was widely distributed to the financial community in the United States. (See Section VI, Fraudulent And False And Misleading Statements). Mr. Fitchey was responsible for the preparation and public dissemination of the Company's Regulation "S" (offshore) Investment Memorandum in 1992 which securities offering and disclosure document

stated that (i) the proceeds from the sale of such stock would enable the Company to be listed on NASDAQ, (ii) revenues for 1992, 1993 and 1994 were projected, respectively, at $2.5 million, $13 million and $30 million and (iii) that the Company would be profitable by the first quarter of 1993. At the time that such statements were made, Mr. Fitchey knew that such statements were false and misleading because at the time Mr. Fitchey knew that the Company had done virtually no consumer taste or other testing of its flavored beverage products (including "Bamboo", "Paradise", "Avalanche", "Java" and "Harvest" flavors) and that the little taste testing which had been done indicated that the Company's products were not being well received by test consumers. Accordingly, Mr. Fitchey knew that there was no factual basis for the Company's extremely aggressive projections of sales revenue and earnings. At the time that Mr. Fitchey prepared and otherwise participated in the preparation of securities disclosure documents for the Company including as referenced above, he knew that the Company's product was defective and turned brown, even with the subsequent addition of EDTA, shortly after (within approximately six months) it was produced. In the Fall of 1992, Defendant Fitchey knew that the Company had an unrecorded liability resulting from such defective product, including the Company's oral and written agreement to repurchase such "pre-EDTA" product, in excess of $1,000,000; however, none of the securities disclosure documents which Defendant Fitchey prepared or caused to be prepared reported or otherwise disclosed such problem and resulting liability.

15. Lee Strader ("Strader") was the Vice President - Sales and Marketing from approximately May of 1992 until his departure from the Company sometime in the latter part of 1993. In such capacity, Mr. Strader was responsible for forecasting and monitoring the sales and marketing efforts of AVBC, including annual budgets relating

thereto. As Vice President - Sales and Marketing, Mr. Strader prepared and participated in the preparation and public dissemination of numerous reports to the SEC, including AVBC's Annual Report on Form 10-K to the SEC for the year ended December 31, 1992, AVBC's Annual Report to Stockholders for the year ended December 31, 1992 and AVBC's S-1, all of which contained statements which Mr. Strader knew were materially false and misleading because at the time Mr. Strader knew that the Company had performed virtually no consumer taste testing of the Company's flavored beverage products and that the little testing that had been conducted showed that the Company's products were not being well received by test consumers. In addition, Mr. Strader has prepared and participated in the preparation and public dissemination of numerous press releases (including projections of sales and profits) regarding the business, financial condition, prospects and affairs of AVBC which he knew were false and misleading because Mr. Strader knew at the time that there was no factual basis for the sales and earnings projections published by the Company.

16. During all periods relevant to the allegations in this Complaint, John A. Good ("Good") was the Company's Vice President - Operations in charge of, among other things, the formulation and quality control aspects of the Company's bottled water product. In such capacity, Mr. Good was responsible for the overall operations of AVBC, including the forecasting and monitoring of sales, cost of sales, anticipated profits and cash flow and the distribution of the Company's bottled water products through the Company's distributorship network. As Vice President - Operations, Mr. Good, to some degree, is believed to have prepared and participated in the preparation and public dissemination of numerous reports to the SEC, including AVBC's Annual Report to the SEC on Form 10-K for the years ended December 31, 1991 and 1992, AVBC's Annual Report to

Stockholders for the year ended December 31, 1992 and AVBC's S-1. In addition, it is believed that to some degree, Mr. Good prepared and participated in the preparation and public dissemination of numerous press releases (including projections of sales and profits) regarding the business, prospects and affairs of AVBC. On information and belief, Mr. Good knew or was reckless in not knowing that such securities disclosure documents contained statements which were materially false and misleading. Mr. Good knew at the time, or was reckless in not knowing, that the Company's profit margins on its beverage products were abnormally low and could not sustain the Company's operations especially in light of the Company's substantial selling, general and administrative costs and expenses which Mr. Good knew or should have known would result in the Company operating at a substantial loss for the foreseeable future. Additionally, Mr. Good knew or should have known that the Company did not have the capital or financing required to purchase/install the equipment that would be necessary for the Company to be able to produce the amount of bottled water product the Company was projecting it would sell. Accordingly, Defendant Good knew or should have known that the Company's sales and earnings projections could not possibly come true. In the Spring of 1992, based upon tests of the Company's proposed new "non-carbonated, slightly flavored" bottled water product which Defendant Good was running at the Company's office/lab in Ketchum, Idaho, Mr. Good was able to confirm that the then current formulae for the product was defective and that, without further refinement and adjustment of such formulation, the Company's product would discolor, turning "brown", shortly after it was produced. Defendant Good reported such test results to the Company's Management, including Defendants Gillespie and Sim, and his recommendation that the first commercial production of the product be delayed long enough to allow him to reformulate the product seeking to overcome such defect. Nevertheless,

Defendants Gillespie and Sim together told Good to proceed with plans to commence commercial production of the product (as currently formulated and without adjustment). Accordingly, in late May or early June of 1992, the Company proceeded with the planned production of its product at Cottell Bottling in Stockton, California. Approximately 60 days following such initial, substantial production run, Cottell reported to the Company that the product still stored in their production facility was discoloring in the bottle and was turning "brown". Shortly thereafter, the Company's distributors who had purchased such product, including Golden Brands which was by far the Company's largest distributor and customer, demanded that the Company repurchase such defective product. In the Fall of 1992, the Company agreed to repurchase all of the defective product (referred to by the Company and Golden Brands as the "pre-EDTA" product) and related items for an amount approximating $1,000,000. Nevertheless, the Company never reported or otherwise disclosed such product defect problem and/or the resulting re-statement of 1992 sales and/or the substantial liability associated therewith. Defendant Good was personally aware of the formulation defect, and was aware or should have been aware of the substantial liability, associated with the Company's product; however, such Defendant was negligent in never causing the Company to report or otherwise disclose such material facts.

17. Robert Bahoshy ("Bahoshy") was the Company's Vice President - Business Development from approximately March 1992 until his departure from the Company sometime in the latter part of 1993. In such capacity, Mr. Bahoshy was responsible for directing the appointment of master and sub-distributors and new product development and introduction for AVBC. Mr. Bahoshy was aware by at least December of 1992 that AVBC's largest distributor, Golden Brands, had initiated the return of a

substantial amount of AVBC's product to AVBC pursuant to the re-purchase provision in the distributorship agreement between Golden Brands and the Company and otherwise; and that Golden Brands had indicated its intention to terminate its distributorship agreement with the Company. As Vice President - Business Development, Defendant Bahoshy prepared and participated in the preparation and public dissemination of numerous reports to the SEC, including AVBC's Annual Report on Form 10-K to the SEC for the year ended December 31, 1992, AVBC's Annual Report to Stockholders for the year ended December 31, 1992 and AVBC's S-1, all of which such Defendant knew contained materially false and misleading statements. In addition, Mr. Bahoshy prepared and participated in the preparation and public dissemination of numerous press releases (including projections of sales and profits) regarding the business, prospects and affairs of AVBC which he knew contained materially false and misleading statements. Bahoshy knew that the Company's securities disclosure communications failed to disclose, among other things, that all of AVBC's distributors had the right to return for re-purchase by the Company all of the AVBC product they had previously purchased (and which had been previously reported as having been sold by AVBC to such distributors).

18. Mark L. Stevens ("Stevens") became a director of the Company in approximately July of 1993, and became President and Chief Executive Officer of AVBC in January of 1994. During his tenure as a Director of AVBC, Mr. Stevens approved and caused the filing and public dissemination of periodic reports to the SEC, including AVBC's Quarterly Reports on Form 10-Q for the three months ended June 30 and September 30, 1993, and prepared and assisted in the preparation and public dissemination of press releases and shareholder/investor communications which he knew contained materially false and misleading statements.

For example, Mr. Stevens was responsible for the preparation and public dissemination of AVBC's February 4, 1994 press release entitled "Aqua Vie To Go 'All Natural' in 1994 And Reviews Sales For 1993". In such press release, the Company announced its new "All Natural" and "No Preservatives" product planned for production in April 1994 and marketing in May 1994. According to the press release, Stevens was brought in to direct the national roll out of the Company's first "functional beverage" line. (Additionally, the Company also reported that AVBC's previously reported sales had to be restated downward due to "unusual Sales Returns & Allowances of approximately $425,000 due to two Master Distributors who did not perform as expected"). Mr. Stevens knew at the time that such press release was false and misleading for, among other reasons, (i) failing to report or otherwise disclose that at such time the Company had lost all of its distributors and was only selling its products in two metropolitan areas (Chicago and Los Angeles), (ii) failing to report or otherwise disclose that the Company's standardized form of distributor agreement allowed the Company's distributors to unilaterally terminate such agreements and to return to the Company for re-purchase by the Company products previously sold by the Company to such distributors, (iii) that the Company had entered into an undisclosed agreement in the Fall of 1993 to repurchase defective product manufactured by the Company in the Summer of 1992 ("brown" water problem), (iv) that the Company had falsified actual sales numbers for the 1st Quarter of 1993 so as to substantially overstate sales during such period and that the above referenced "sales adjustment" of $425,000 was designed to cover-up and conceal that the Company had previously falsified reported sales, (v) that the Company's non-carbonated, lightly flavored bottled water product line, which was announced ready for sale in 1991 but was not actually first produced for commercial sale until the Summer of 1992, was a failure and had resulted in substantial unpaid obligations and

liabilities in respect of which the Company had no ability to pay, or any prospect for obtaining money with which to pay, such liability, (vi) that financial statements previously issued by the Company, including for the 3rd Quarter and the Company's Quarterly Report to the SEC for such three month period ended September 30, 1993, covered-up and concealed various adverse material facts including without limitation the Company's failure to secure payment for the issuance of stock previously recorded and reported as "paid in capital", and (v) such "new product" press release failed to report or otherwise disclose that the Company lacked the financial resources to introduce, promote, offer and sell any new line of beverage products on a nationwide basis or otherwise including as announced by Defendant Stevens in the Company's press and "news letter" releases issued at or about such time. As a Director of the Company, Defendant Stevens owed fiduciary and other special duties to the Company and to its securities holders including the Plaintiffs and the Class including to oversee and supervise the Company's Management and the reporting by such Management to the Company's securities holders and other public investors. Following the time that Defendant Stevens knew, or was extremely reckless and negligent in not knowing, that Defendant Thomas Gillespie and other members of the Company's Management were causing the Company to issue and publicly disseminate false and misleading financial statements and other securities disclosure information, Defendant Stevens took no action to attempt to remedy and correct such situation and thereby knowingly and intentionally allowed such wrongful activity and conduct to continue, and he thereafter prepared and participated in the issuance and dissemination of further false and misleading statements by the Company, to the further detriment and damage to the Plaintiffs and the Class.

19. Aqua Vie Beverage Corporation (herein "AVBC") is a Delaware corporation. Prior to January

8, 1991, AVBC was known as The JIB GROUP, INC. At all times relevant to the allegations of the Complaint, AVBC was a public reporting company under Section 12 of the Securities Exchange Act, and AVBC's Common Stock was listed for trading on the Boston Stock Exchange ("BSE"). Prior to its listing on the BSE, AVBC Common Stock was traded in the national over-the-counter market (including on the NASDAQ Bulletin Board), and over a dozen broker/dealer firms throughout the United States acted as "market makers" for and otherwise participated in the public trading market for the Company's stock.

20. Deloitte & Touche ("Deloitte") is a large, nationally recognized public accounting firm which provides accounting, auditing, tax and related business and financial consulting and advisory services including to AVBC during the period covered by this Complaint. Deloitte audited AVBC's (KWC's) consolidated financial statements for the year ended and as at December 31, 1990 and, in such capacity as AVBC's outside independent auditors, issued their report and opinion thereon dated August 28, 1991 (the "1990 Audit"). Prior to the conclusion of such audit and the issuance of Deloitte's report and opinion on such 1990 audited financial statements in August of 1991, Deloitte was aware that the Company had received a substantial advance of funds from one of its stockholders, Frank Lopez, representing a substantial actual (or contingent liability) of the Company in respect of such advance and the Company's promised, but lack of performance, in respect thereof. Notwithstanding such liability, and its substantial negative impact of the Company's financial condition and solvency, the Company's 1990 audited financial statements, as reported upon by Deloitte, did not report or otherwise disclose such liability rendering such 1990 financial statements, and Deloitte's report and opinion thereon, false and misleading. Deloitte also audited AVBC's consolidated financial statements for the year ended and as at

December 31, 1991 and, in such capacity, issued their report and opinion thereon dated February 14, 1992 (the "1991 Audit"). Deloitte also audited AVBC's consolidated financial statements for the year ended and as at December 31, 1992 and, in such capacity as AVBC's outside independent auditors, issued their report and opinion thereon dated March 11 and June 7, 1993 (the "1992 Audit"). Deloitte's reports and opinions on AVBC's audited financial statements as referenced above were addressed "To The Stockholders Of Aqua Vie Beverage Corporation". The Company's 1991 and 1992 audited financial statements did not report or otherwise disclose any obligation or liability, actual or contingent, in respect of the monies advanced by Lopez to the Company in 1991 totalling approximately $680,000; and, instead and without any factual basis for doing so, such 1991 and 1992 audited financial statements reported the money advanced by Lopez to and received by the Company as a "capital contribution" by Lopez (and did not report or otherwise disclose the Company's agreement to issue "replacement" shares of its capital stock to Lopez as consideration for the sale of AVBC shares owned by Lopez and the transfer of proceeds from the sale of such shares to the Company as working capital). As part of its auditing, accounting, consulting and advisory services in 1992, Deloitte advised and assisted Gillespie, Mullen and Karban (the so-called "Entrepreneurial Team") in respect of the issuance by AVBC of certain (2.5 million) free employee bonus ("entrepreneurial") shares to such persons and the back dating of such proposed stock issuance matter and documentation to early in 1991 prior to the existence of a public trading market for AVBC's stock. Deloitte knew at the time that Defendants Gillespie, Mullen and Karban were falsifying AVBC's corporate books and records to reflect such employee stock bonus transaction as having taken place in 1991 instead of 1992 when such proposed transaction was being considered. With Deloitte's knowledge, assistance and concurrence, in February of 1992

Gillespie, Mullen and Karban back-dated corporate minutes and stock records to reflect the issuance of 2.5 million shares of the Company's Common Stock to them in January of 1991 at a price per share of only $.001 when the actual value of such shares, as determined by the then public trading market for the Company's shares was approximately $4 per share. Accordingly, the expense attributable to such employee compensation transaction was understated on AVBC's financial statements for 1992 in the approximate amount of $10 million. The reporting of the issuance of such 2.5 million shares in the Company's 1991 audited financial statements, as having taken place in January of 1991, was done notwithstanding the fact that Deloitte had received written confirmation from the Company's independent stock transfer agent and registrar confirming to Deloitte that such 2.5 million shares were not issued and outstanding on the Company's stock transfer books and records at December 31, 1991; and Deloitte's receipt from Defendant Karban, almost immediately prior to the recording in 1992 of the issuance of such 2.5 million shares in 1991, of written confirmation of the number of shares of AVBC stock outstanding at December 31, 1991 and during the twelve month period then ending, which did not include such 2.5 million shares. Also as part of its auditing, accounting, consulting and advisory services to AVBC in 1992 pertaining to the Company's 1991 year-end financial statements, Deloitte advised Gillespie and aided and assisted Gillespie and Karban in causing AVBC to assume and pay Gillespie's personal obligation and debt in the amount of $81,638 for the prior purchase by Gillespie of shares of the Company's Common Stock (formerly KWC stock subsequently exchanged for shares of the Company's Common Stock) from former shareholders of the Company. During the course of its auditing, accounting, consulting and advisory services to AVBC in 1992 and 1993, Deloitte aided and assisted AVBC in the structuring and recording of additional stock compensation awards to employees (including Gillespie, Mullen, Wilson, Sim, Karban,

Fitchey, Strader, Good and Bahoshy) in an amount which materially understated the value of such awards and the expense attributable thereto, thus further reducing AVBC's net loss for the year ended and as at December 31, 1992 in the approximate amount of $3 million. Subsequent to the publication of AVBC's 1992 Annual Report to the SEC on Form 10-K for the year ended December 31, 1992, AVBC revalued the prior year's stock compensation awards and restated its net loss for 1992, materially increasing such loss for such period, and further reducing stockholders' equity on AVBC's audited balance sheet in the approximate amount of $3 million. Deloitte's report and opinion for the year ended December 31, 1991 was published and otherwise publicly disseminated in AVBC's Annual Report to the SEC on Form 10-K for the year ended December 31, 1991 and AVBC's S-1. Deloitte's report and opinion for the year ended December 31, 1992 was published and otherwise publicly disseminated in AVBC's Annual Report to Stockholders for the year ended and as at December 31, 1992 and AVBC's Annual Report to the SEC on Form 10-K for the year ended and as at December 31, 1992. Deloitte's reports and opinions on AVBC's 1991 and 1992 audited financial statements failed to report or otherwise disclose that the Company's standardized form of distributor agreement contained provisions entitling such distributors to require AVBC to re-purchase products previously sold by the Company to such distributors, and failed to report or otherwise disclose such contingent and actual liability in the Company's audited financial statements in respect of which Deloitte issued its opinions and reports. For purposes of its audit of the Company's 1992 year-end financial statements, Deloitte failed to audit the Company's inventory of bottled water product located in the Company's rented warehouse facility in Stockton, California, notwithstanding the fact that Deloitte's accounting work papers for such audit reflect the Company's obligation to Golden Brands, who subcontracted for the production of such bottled water inventory by Cottell Bottling

Company for resale to the Company, for product purchased by the Company from Golden Brands in 1992 in the amount of approximately $95,000. Likewise, Deloitte did not make any effort to confirm directly with Golden Brands the balance due and owing by the Company to Golden Brands at December 31, 1992, which liability included not only the $95,000 payable attributable to the Company's purchase of inventory from Golden Brands (manufactured by Cottell for Golden Brands resale to AVBC) reported by the Company to and as noted in Deloitte's workpapers, but also the liability of the Company to Golden Brands attributable to the unsalable ("brown" water) product water manufactured for Golden Brands for resale to its customers based upon the Company's defective formulae including ingredients purchased by Golden Brands from the Company in order to produce such product in the approximate amount of $1,000,000. The Company's 1992 year-end financial statements did not reflect any liability by the Company to Golden Brands at December 31, 1992 (only a modest receivable from Golden Brands).[1/] As a result of Deloitte's failure to count the Company's inventory of bottled water product on hand at December 31, 1992, Deloitte failed

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[1/] The Company sold the use of its formulae and ingredients used therein to Golden Brands for use in Golden Brands manufacture of the Company's bottled water product for Golden Brands' own account to be resold by Golden Brands as a wholesaler to its sub-distributors and directly to Golden Brands large retail accounts. Golden Brands also contracted for the manufacture of the Company's bottled water product for sale to the Company and resale by the Company to other distributors for resale od such product to their sub-distributors and direct retail accounts. Accordingly, Golden Brands (including through its subcontractor Cottell Bottling) was both a vendor of finished goods inventory to the Company and a customer of the Company's buying the ingredients from the Company used to produce and bottle the Company's product.

to discover that all such pre-EDTA was defective and had to be repurchased by the Company. Similarly, Deloitte failed to require the Company to reflect its payable to Golden Brands for product sold and shipped by Golden Brands to the Company in 1992 in the amount of $95,000 at December 31, 1992, or to discover that the Company was obligated, and had agreed, to repurchase all pre-EDTA inventory in the hands of its distributors at the end of 1992 representing a liability of approximately $1,000,000. Although Deloitte purported to audited AVBC's 1990 and 1991 financial statements, actually it was Deloitte which drafted and otherwise physically prepared and printed such financial statements for the Company then purported to proceed to audit such financial statements as AVBC's outside independent auditor. Deloitte regularly reviewed and commented upon the Company's proposed quarterly reports to the SEC, including unaudited financial statements, on Form 10-Q before they were filed with the SEC and otherwise publicly disseminated. Deloitte advised and otherwise assisted the Company to record and report in the Company's 10-Q Report for the three months ended March 31, 1993 and otherwise that sales of stock by the Company, in respect of which the Company had not actually received payment for such sale of stock from the purported buyers thereof, had resulted in the receipt of such proceeds by the Company by classifying such receivable as part of the Company's capital account contrary to applicable accounting rules and regulations prohibiting the classification of "subscriptions receivable" as capital unless and until payment for such stock has actually been received by the issuer/reporting company thereby rendering the Company's 1st Quarter 1993 financial statements, and reports thereon and in respect thereof including press releases issued by the Company, false and misleading. Deloitte, in accepting the engagement to act as AVBC's independent auditor in 1991 and to audit the Company's 1990 year-end financial statements, failed to take proper steps to investigate the background of the Company and

Gillespie as its founder/president/principal stockholder, and failed to recognize or otherwise learn that the State of Hawaii had recently issued a cease and desist order against the Company and Gillespie enjoining the sale of the Company's water product in Hawaii or that Gillespie had been convicted of criminal bankruptcy fraud, and was thus a convicted felon, and thereafter to take steps to properly ensure that the Company's financial statements were accurate and complete in all material respects free of any influence by Gillespie to falsify such financial statements which turned out to be the case. For example, without conducting any audit or other confirmation work as to the background and nature of the Lopez funds transfer transaction in 1991, Deloitte advised the Company it was proper and otherwise approved the recording of the approximately $680,000 the Company received from Lopez as a "contribution to capital" in the capital section of the Company's balance sheet instead of properly classifying such transfer as a "liability" on the Company's balance sheet as at December 31, 1991 and 1992 (and as a "subsequent event" noted in the Company's 1990 year-end balance sheet which was published and reported upon by Deloitte after the Company had received all or substantially all of the advance of funds from Lopez). In their report and opinion on the Company's 1991 and 1992 year-end financial statements, Deloitte did not report or otherwise disclose, and the Company's financial statements did not report or disclose, the Company's agreement to issue "replacement" shares to Lopez in consideration for the shares of the Company's stock owned and sold by Lopez (1,000,000 shares) to generate the proceeds transferred by Lopez to the Company in 1991 and/or to otherwise report and disclose certain other actual or contingent liabilities associated with or resulting from such "Lopez transaction". After the initiation of litigation regarding the Lopez transaction, including without limitation Lopez' action against the Company to recover the $680,000 he had advanced to the Company and for other damages he had suffered as a

result of the Company's failure to perform its agreements with Lopez, Deloitte continued to report and opine on the Company's audited financial statements which did not report or otherwise disclose any debt, obligation and/or liability of the Company to Lopez in respect of the Lopez transaction including any liability of the Company to Lopez for the $680,000 he had transferred to the Company without having received any consideration therefor which money the Company retained and continued to classify, without factual justification, as a "capital contribution". In auditing the Company's financial statements for the years ended 1992, 1991 and 1990, Deloitte made no effort to communicate with, and did not communicate with, Lopez to attempt to determine any facts relating to the Lopez funds transfer and the proper classification of such on the Company's books and records including whether or not Lopez intended such advance to actually be a contribution to capital of the Company by Lopez without the receipt of any payment or other consideration from the Company to Lopez. As a result of its failure to properly audit the Lopez transaction, the reports and opinions issued by Deloitte on the Company's 1990, 1991 and 1992 year-end financial statements were thereby rendered negligent and fraudulent and otherwise false and misleading. Similarly, without any contemporaneous documentation to support the recording and reporting of such transaction as a "1991 transaction", and notwithstanding written confirmation from the Company's stock transfer agent and prior representations from the Company to the contrary, Deloitte advised the Company in respect of and otherwise approved the recording on the Company's books and records for the first time in 1992 of the issuance of 2.5 million shares of the Company's stock to the Entrepreneurial Team (Defendants Gillespie, Mullen and Karban) effective in 1991 for $.001, and the recording of an expense attributable to such "free" issuance of such shares to such insiders of only $2,500, when the then current trading price for such shares was approximately $4 per share resulting

in an expense to the Company of approximately $10,000,000. At the time that Deloitte was auditing the Company's 1990 year-end financial statements in 1991, Deloitte obtained, read and placed in its "permanent" files on AVBC copies of the distributor agreements between the Company and its distributors (in standardized form). Such agreements expressly provided that the distributors had the right to cause the Company to repurchase from the distributors any unsold inventory of the Company's products previously purchased and paid for by the distributors when and if the distributorship which was the subject of such agreements was cancelled by the distributors. Neither the existence of such mandatory "buy-back" provision, the contingent liability represented thereby including the possible future affect of such buy-back provision on previously reported sales nor the actual exercise of such "put" by the Company's distributors including Golden Brands was ever reported or otherwise disclosed in the Company's financial statements audited and reported upon by Deloitte. The failure to report and disclose such contingent (and subsequently actual) liability, in respect of the Company's obligation to buy-back product previously reported as having been sold, in the Company's 1991 and 1992 year-end financial statements rendered such financial statements false and misleading and Deloitte's audit reports and opinions on such financial statements fraudulent and negligent (and otherwise false and misleading). As a result of accepting the engagement to act as the Company's outside, independent accountant and auditor, and to audit the Company's 1990, 1991 and 1992 year-end financial statements and to report to the Company's securities holders thereon, Deloitte entered into a "special relationship" with and owed fiduciary or other special duties to the Company and its securities holders including the Plaintiffs and the Class.

V.

CLASS ACTION ALLEGATIONS

21. Plaintiffs seek to bring this action as a "Class Action" under FRCP Rule 23(b)(3) because they are informed and believe that their claims are typical of the claims including questions of law and fact common to all members of the class or possible subclasses and which common questions of law and fact predominate over any questions affecting only individual class members; and that a Class Action is superior to other available methods for the fair and efficient adjudication of the controversy which is the subject of this lawsuit.

22. The definition of the proposed class (the "Class") consists of all persons who purchased the debt or equity securities of AVBC during the period commencing August 1, 1991 through February 28, 1994 (the "Class Period") and who never served as an employee, officer or director of AVBC.

23. Included in the Class of persons whose claims are the subject of this Complaint are all of the persons who during the Class Period purchased (i) shares of the Common Stock of AVBC, (ii) warrants entitling such persons to purchase shares of the Common Stock of AVBC, and (iii) AVBC's 5% Convertible Subordinated Debentures due December 31, 1994.

24. The proposed Class is believed to consist of in excess of 2,000 persons.

25. The proposed Class representatives' attorney is knowledgeable about the subject matter of the Complaint, has successfully brought, maintained and concluded

other securities class actions, and is believed to be capable of adequately representing the Class in the instant lawsuit.

26. The claims which are the subject matter of the Complaint are believed to be common to the Class and/or one or more subclasses (herein collectively the "Class") and involve principally the failure of AVBC, AVBC's Management and Deloitte to disclose certain material information which investors could reasonably have been expected to want to know in formulating investment decisions regarding the securities of AVBC and which undisclosed information would have altered the total mix of available information in respect of such securities so as to render such information as being "material".

27. Members of the proposed Class purchased securities of AVBC without the benefit of material information which was omitted from AVBC's securities disclosure and other publicly disseminated statements, reports and information in reliance upon the integrity of the public trading markets for such securities (and the resulting trading prices for such securities in such public trading markets) and in connection with fraudulent and false and misleading statements, reports and information that was publicly disseminated in respect of AVBC's securities.

28. Based upon information currently available to the Plaintiffs, there is presently believed to be no action pending in respect of the matters which are the subject of the Complaint initiated by any members of the proposed Class. The filing of the instant action was prompted in part by considerations relating to the statute of limitations applicable to one or more of the claims and theories of recovery stated herein, and the absence of anticipated difficulties in the management of the instant action as a Class Action collectively substantiates the determination to prosecute this action and the

claims stated herein as a Class Action for and on behalf of the prospective members of the Class in the judicial district wherein this action has been filed (and was subsequently transferred). FRCP Rule 23 notice, in respect of this Class Action, is anticipated to be provided in writing delivered via the U.S. Mail.

VI.

FRAUDULENT AND FALSE
AND MISLEADING STATEMENTS

29. During the Class Period, AVBC under the direction and control of the Management thereof knowingly, intentionally and recklessly made fraudulent and false and misleading statements to the public trading markets for AVBC's securities and to holders of such securities including the Plaintiffs about AVBC's business, property, management, results of operations, financial condition and future prospects affecting and in connection with the purchase and sale of AVBC's securities, including but not limited to the following:

(1) In a "Dear Investor" letter published and otherwise publicly disseminated by AVBC in May 1991 under Gillespie's name, it was stated that,

> "In an attempt to keep all investors in Aqua Vie Beverage Corporation up to date on the most recent events we would like to convey the following events: Aqua Vie is seeking financing at a level that would be extremely advantageous for current shareholders. Aqua Vie has also signed a private labeling contract with a division of Suntory out of Japan which will result in excess of 5 million in first year revenues for

> the Company. Aqua Vie has also signed on the 3 largest grocery chain stores based in California whose names will be released within the next three weeks . . . Although the stock has increased over 100%, we feel because of the upcoming events, that our stock is undervalued".

(2) The foregoing statements were false and misleading because AVBC had not entered into agreements with the three largest grocery chain stores in California and AVBC had not signed an agreement with Suntory.

(3) On or about June 20, 1991, AVBC reported in The Marketarian Investment Advisory Letter that 1991 revenue was projected at $15-20 million with expected profits of $4.5-$5 million and revenues of $80-$100 million for 1992 and that the Company had applied for NASDAQ listing. The Company did not apply for NASDAQ listing until the fall of 1992.

(4) On or about August 23, 1991, AVBC filed with the SEC and otherwise publicly disseminated its Quarterly Report on Form 10-Q for the three months ended March 31, 1991 and included therein were AVBC's unaudited financial statements for the three months ended and as at March 31, 1991 which stated at Note 3, Notes Payable, to such financial statements that "Notes payable [$81,638] at March 31, 1991 are payable to former shareholders of KWC, Inc. The note bears interest at 12 percent per annum and is payable in twelve monthly installments, with the final payment due on December 31, 1991". (Such statement was repeated in AVBC's Quarterly Reports to the SEC for the three month period ended and as at June 30 and September 30, 1991).

(5) Such 10-Q Report also stated at page 7 that, "The Company estimates the immediate sales potential for the non-carbonated flavored waters in the United States exceeds $200 million annually and the first three months capacity for the company may exceed $10 million".

(6) On or about August 28, 1991, AVBC published its audited financial statements for the year ended and as at December 31, 1990 which stated in Note 3, Notes Payable, to such financial statements that, "Note payable [$81,638] at December 31, 1990 is payable to former stockholders of the company. The note bears interest at 12% per annum and is payable in twelve monthly installments, with the final payment due on December 31, 1991".

(7) The foregoing statements were materially false and misleading because the Note Payable referred to therein was prepared by Gillespie and Karban (with the concurrence and assistance of Deloitte) and failed to report or otherwise disclose that Gillespie had caused AVBC to assume and pay his personal debt and obligation to certain former stockholders of the Company (KWC) for the prior purchase of their shares of the Company's stock by Gillespie thereby overstating AVBC's liabilities (to the personal benefit of Gillespie).

(8) On or about August 28, 1991, AVBC also made the following statement at Note 5, Treasury Stock Transactions, in its December 31, 1990 audited financial statements:

> "During 1990, 510 shares of no par common stock were acquired by the company for 10 cents a share. Of these, 410 shares were then purchased by the Company's chief executive officer at 10 cents per share under a stock purchase agreement. The remaining 100

> shares were later sold to a group of investors for $100,000. Proceeds of $100,000 were used to pay down working capital loans from former stockholders."

(9) The above statement was materially false and misleading because Gillespie, not AVBC, had acquired the subject shares from former shareholders of the Company (KWC) resulting in Gillespie's personal debt and obligation to such selling shareholders for the debt and obligation that Gillespie subsequently caused AVBC to assume and pay for him. Gillespie not AVBC then sold 10% of the acquired shares to three other individuals for $100,000 to fund Gillespie's down payment for the shares he was purchasing for his own account (thereby allowing Gillespie to purchase for $51 the same shares for which he later caused AVBC to pay, at a minimum, $81,638).

(10) The above referenced Note 5, Treasury Stock Transactions, to AVBC's 1990 audited financial statements was also prepared by Gillespie and Karban (with the concurrence and assistance of Deloitte).

(11) On or about August 28, 1991, AVBC published and publicly disseminated a press release entitled "Aqua Vie Beverage Corporation Announces Results of Trade Show in Los Angeles and First Bottling Run of New 'Hana' Water" in which Gillespie was quoted as saying, "This [trade show] confirms our market research, [and] we anticipate producing a minimum of 2.5 million cases ($19 million) during the next twelve months."

(12) In a November 22, 1991 "Dear Stockholder" letter, Gillespie made the following statements:

> "Because of the success of Aqua Vie's 1991 research, the Company is also planning to

> introduce two new product lines in 1992. A line of nutritionally enhanced products . . . to be marketed by a multi-level marketing company [and] a line of nutraceutical products . . . to be marketed by the health care industry . . . Current distribution markets for Aqua Vie products exceed projections, and the Company expects to see substantial sales and profitability in the coming years."

(13) In approximately October of 1991, and continuing through at least May 1992, AVBC published and otherwise publicly disseminated an "Investor's package" which contained the following statement:

> "In the fall of 1990, Aqua Vie introduced 'Aqua 'bacteria free bottled water at Interbev in Chicago, a national trade show for beverage distributors. The response from attending distributors was notable resulting in sales orders in excess of forty million dollars".

(14) Beginning at least as early as March 18, 1992, AVBC, Gillespie and Karban filed with the SEC and otherwise publicly disseminated AVBC's Annual Report on Form 10-K for the year ended December 31, 1991 (the "1991 10-K Report"), under cover of a "Dear Investor" letter to shareholders and prospective investors signed by Karban which included the statement that, "The consumer response to our product testing has been very positive."

(15) Such statement was made without any factual basis, and in November 1992 when AVBC did conduct some limited consumer tests of its products, the results of such tests indicated that the Company's products were not well received by the public.

(16) AVBC's 1991 10-K Report, in addition to incorporating the false and misleading notes to AVBC's audited financial statements for the year ended and as at December 31, 1990, reported at Item 12, pp. 16-17, "Security Ownership of Certain Beneficial Owners and Management", that the number of shares of AVBC Common Stock owned by Gillespie was 11,208,000 which included 3,640,000 shares which were not actually owned by Gillespie but were owned by former KWC shareholders (240,000), Sim (1,000,000) and Kevin Woodbridge (2,400,000).

(17) On or about March 30, 1992, in the Marketarian, an investment advisory publication, AVBC indicated that it was planning national distribution by the end of the year and was projecting $17 million in revenue and earnings in the $.25 to $.30 per share range.

(18) On or about May 14, 1992, AVBC filed with the SEC and otherwise publicly disseminated its Form 10-Q Report for the three months ended March 31, 1992 which Report stated, in pertinent part, that,

> "Although the Company is in negotiations with several investment banking firms and others for equity investments in the Company, management believes that with the sales of product in limited areas during the summer of 1992, the Company will be able to fund operations and capital requirements entirely through sales of product. Equity partners are being sought to enable the Company to achieve nationwide coverage with the product by the end of 1992".

(19) The above quoted statement was false and misleading for failing to disclose that during the same

three month period AVBC had received and used as working capital approximately $728,000 resulting from the sale of stock by the Company and by Gillespie for and on behalf of the Company.

(20) In a press release published and publicly disseminated by AVBC on or about June 30, 1992 entitled "Aqua Vie Beverage Corporation Commences Shipping", Gillespie made the statements that, "We anticipate that for the first full operating year, ending December 31, 1992, sales are expected to reach 2 million cases, valued at approximately $20 million" and he went on to state that the Company expects to see sales of 5 million cases at a value of $50 million for 1993.

(21) On or about August 1, 1992, AVBC published and otherwise publicly disseminated a communication described as a "Business Overview" in which AVBC forecasted 1993 sales of $8.6 million with earnings exceeding $1.5 million.

(22) Beginning in September 1992, and continuing at least through December 1992, AVBC published and otherwise publicly disseminated an "Investment Memorandum" to prospective investors which contained the following statements:

> (i) This [$7 million] funding will also allow the Company to be listed on NASDAQ and thus provide a source for future funding as required . . . ;
>
> (ii) The gross margins to the Company from the sale of the spring water and flavor concentrate, once the master distributor and regional bottling network is established, will exceed 75%;

(iii) The Company's public stock position allows for multiple sources of capital, as well as providing both stock appreciation and the total sale of the Company via consolidation within the beverage industry, as viable exit strategies for investors;

(iv) The Company also is in negotiations with various other parties and anticipates having full North American coverage by early 1993;

(v) The Company anticipates sales of water and concentrate . . . representing $2.5 million in revenues [in 1992] . . .;

(vi) Revenues in 1993 to the Company should exceed $13 million . . . Projected earnings for 1993 are $1.4 million;

(vii) Case sales for 1994 are projected to exceed 8 million cases [representing revenue of approximately $30 million]; and

(viii) The Company believes that it will begin profitable operations by the first quarter of 1993.

(23) On or about November 13, 1992, AVBC filed with the SEC and otherwise publicly disseminated its Form 10-Q for the three months ended September 30, 1992, stating that,

"Working Capital at September 30, 1992 was a negative $234,355. This is due to the fact that Accounts Payable increased significantly during the three months ended September 30, 1992. The Company intends to get back to positive Working Capital through

anticipated earnings in the first half of 1993, as well as additional equity and debt financing."[2/]

(24) In a press release published and otherwise publicly disseminated on or about December 16, 1992 entitled "Aqua Vie Receives Subscriptions To $4 million In Private Placements", AVBC announced that,

> "[I]t has received subscription agreements for over $4 million in private placements of restricted stock. This is over half of a European private placement offering of $7.4 million that began on December 10, 1992. The Company has not closed escrow on the subscriptions received but expects to do so by the end of the year".

(25) Such press release quoted Gillespie as follows: "We are very pleased with the rapid pace at which the private placement will enable the Company to complete standard quantitative NASDAQ listing requirements".

(26) On or about February 16, 1993, the Company's Form S-1 Registration Statement under the Securities Act of 1933 as filed with the SEC (signed by Gillespie, Mullen, Sim, Wilson and Karban) became effective containing the following statements:

(i) At p. 3, the Company stated that "gross margins to the Company . . . will be approximately 75%";

(ii) At p. 4, the Company stated that it was "in

[2/] Such disclosure points out the false and misleading nature of AVBC's earlier (March 31, 1992) statements. See para. 29(17) above.

negotiations . . . with Master Distributors to cover all 50 United States, Canada and Mexico by early 1993 and selected international markets by early to mid 1993";

(iii) At p. 15, the Company stated that "The table below details the current product costs and margins" (such Table reflected "Gross Margins to the Company" of 75%);

(iv) At p. 18, the Company stated that it "intends to get back to positive working Capital through anticipated earnings in the first half of 1993 . . . "; and

(v) At p. 30, the Company reflected T. Gordon Sim's ownership of AVBC Common Stock at 350,000 shares (failing to disclose that Gillespie held 1,000,000 AVBC shares owned by Sim).

(27) AVBC's S-1 also contained the Company's audited financial statements for the year ended and as at December 31, 1991 reflecting the "working capital loan" in the amount of $81,638 which the Company had assumed for the benefit of Gillespie and which failed to report or otherwise disclose the contingent liability represented by the Company's form of Master Distributor Agreement which afforded distributors the right to unilaterally terminate the agreement and to require the Company to re-purchase product previously sold by the Company to such distributors.

(28) AVBC's S-1 also failed to report or otherwise disclose that by December 1992 Golden Brands, AVBC's largest Master Distributor accounting for 55% of AVBC's reported revenues for the nine months ended September 30, 1992 had informed the Company that it was

terminating its distributorship relationship with the Company and was returning its substantial inventory of the Company's products for re-purchase by the Company.

(29) In a press release published and otherwise publicly disseminated by AVBC on or about March 30, 1993 entitled "Aqua Vie Meets Quantitative Qualification Criteria For NASDAQ Basic Listing", AVBC announced that "its balance sheet at March 26, 1993 reflects total assets and capital and surplus sufficient to meet the minimum quantitative requirements for a NASDAQ basic listing" . . . and quoted Gillespie as stating that "the balance sheet numbers were achieved by recognizing as assets subscriptions received from European investors in a Regulation "S" offering the Company is currently conducting, an accounting entry in full compliance with Generally Accepted Accounting Principles ('GAAP')" . . . and that "The Company anticipates having national coverage and expansion in Europe by mid-1993".[3/]

(30) On or about April 13, 1993, AVBC filed with the SEC and otherwise publicly disseminated its Quarterly Report on Form 10-Q for the three months ended March 31, 1993 which stated that,

> "The Company anticipates that by the end of 1993 up to approximately 75% of all sales will be generated through the sale of concentrate and water, while approximately

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[3/] Such statement was false and misleading in that it failed to report or otherwise disclose that in accordance with SEC Rule 5-02.30 of Regulation S-X, stock subscriptions receivable cannot be considered as "equity" for financial reporting purposes until such subscriptions actually are collected. AVBC did not meet NASDAQ "quantitative qualification criteria" - - not then, not ever.

25% of sales will be generated through the sale of finished goods. Therefore, Management expects cost of sales to decrease into the 37.5% range as the Master Distributor program and associated bottling is fully implemented".

(31) Also reported in AVBC's Form 10-Q for the three months ended March 31, 1993 on AVBC's Balance Sheet at such date were "Stock Subscriptions Receivable" totalling $3.6 million which should not have been reflected on the Company's Balance Sheet and in respect of which no such subscription agreements had actually existed.

(32) In a press release published and publicly disseminated by AVBC on or about June 22, 1993 entitled "Key Market Launch On Schedule With Completion Of First Series of T.V. Commercials", AVBC announced that,

"The Company estimates sales revenue for the remainder of 1993 to exceed $12 million, excluding potential international sales from an initial launch in Great Britain. With full national distribution and media coverage, the forecast for 1994 is 8.5 million cases. The Company anticipates being cash flow positive in the fourth quarter of 1993, and profitable in fiscal 1994".

(33) Also on June 22, 1993, Lee Strader, Vice President - Sales and Marketing at AVBC, was quoted in Corporate Reports, an investment advisory newsletter, as follows:

"I am very pleased with the initial distribution success and overall product acceptance. Southern California is the nation's

> largest and most competitive bottled water and New Age beverage market, and is often a trend-setter for the industry. Success in California often sets the blueprint for success across the country".

(34) On or about July 1, 1993, AVBC published and otherwise publicly disseminated its 1992 Annual Report to Stockholders for the fiscal year ended and as at December 31, 1992, which AVBC's audited financial statements for the year ended and as at December 31, 1992 as included in such Annual Report to Stockholders stating, at Note 14, Restatement of Financial Statements thereto, that AVBC and its independent auditor, Deloitte, had miscalculated AVBC's 1992 Common Stock incentive grants as previously publicly reported in AVBC's Annual Report to the SEC on Form 10-K for the year ended and as at December 31, 1992 resulting in an understatement of AVBC's prior reported loss for such period in the amount of approximately $3 million.

(35) On or about August 14, 1993, AVBC filed with the SEC and otherwise publicly disseminated its Quarterly Report on Form 10-Q for the three months ended and as at June 30, 1993, stating that,

> "The Company anticipates that by the end of 1993 approximately 25% of all sales will be generated through the sale of water and concentrate, while approximately 75% of all sales will be generated through the sale of finished goods . . . Therefore, Management expects cost of sales to decrease to the 50% range as the Master Distributor program and

associated bottling is fully implemented."[4/]

(36) Also reported in AVBC's Form 10-Q for the three months ended June 30, 1993, on AVBC's Balance Sheet at December 31, 1992 included therein, was an increase in both "Additional Paid In Capital" and "Accumulated Deficit" approximating $3 million resulting from the Company's restatement of its prior year's financial statements for stock compensation awards granted to employees in 1992.

(37) Such 10-Q Report and within financial statements did not report or otherwise disclose or discuss any reversal of the prior (at March 31, 1993) "Stock Subscriptions Receivable" in the amount of $3.6 million or the reason that such receivable no longer was reflected on Aqua Vie's Balance Sheet at June 30, 1993.

(38) On or about October 1, 1993, AVBC sent its Notice of Annual Meeting and Proxy Statement to stockholders of record at the close of business on September 8, 1993 including the Company's audited financial statements for the two years ended and as at December 31, 1992 and 1991, and stating at p. 17, that,

> "Management expects a positive cash flow from Operating Activities with an increase in sales and a resulting operating profit by the first quarter of 1994".

(39) On or about November 12, 1993, AVBC filed with the SEC and otherwise publicly disseminated its Quarterly Report on Form 10-Q for the three months ended

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[4/] Note that this statement is directly opposite to the statement made regarding cost of sales just three months earlier. See para. 29(30) above.

September 30, 1993, which Report included the following statements:

(i) Management believes that the fundsgenerated from operations and expected additions to capital from the sale of Common Stock, the sale of restricted Common Stock through private placements or through borrowings, will be sufficient to meet the Company's current and long-term obligations and debt payments as they become due;

(ii) Currently, the Company has contracted with master distributors for distribution of the Company's products covering 34 states;

(iii) The Company expects to conclude agreements for distribution of its products in all 50 states and Canada by the end of the First Quarter 1994;

(iv) In addition, the Company initiated sales in Southern California in June 1993 through the use of a direct to retailer distribution system. This method was selected due to the unique characteristics of the market and the need for the associated retailer support. The Company has recently contracted with a broker, in a similar format, to cover the state of Florida;

(v) Negotiations have concluded regarding international distribution in Japan;

(vi) Revenues for the nine months ended September 30, 1993 were $1,139,998, and Revenues for the nine months ended September 30, 1992 were $1,172,604; and

(vii) Selling, General and Administrative Expenses . . . for the nine months ended September 30, 1993 [included] a product replacement program costing $388,874.

(40) In both a press release published and otherwise disseminated by AVBC dated February 4, 1994 entitled "Aqua Vie To Go 'All Natural' In 1994 And Reviews Sales For 1993" and in a shareholder/investor communication mailed and otherwise publicly disseminated during the third week of February 1994, AVBC announced that it was set to roll out for national distribution a new line of "functional" bottled water products; however, the Company failed to report or otherwise disclose that its had no national distribution network because all of its previously announced distributors had resigned and that the Company did not have the financial resources to introduce, offer, sell and promote such new line of beverage products on a national basis or otherwise rendering such announcements materially false and misleading.

(41) Deloitte's reports and opinions, stating that each of AVBC's 1991 and 1992 year-end financial statements were audited by Deloitte in accordance with generally accepted auditing standards and that such financial statements and each of them fairly presented the financial position, the results of operations and cash flows for the dates and periods covered by such financial statements in conformity with generally accepted accounting principles, were false and misleading for the reasons alleged herein and elsewhere in this Complaint, including without limitation because such 1991 and 1992 financial statements, at respectively Notes 7 and 8 thereof, reported that, "During 1991 . . . on behalf of the Company one stockholder [Frank Lopez] sold 1,000,000 shares of common stock at prices ranging from $1.25 to $3.6875 per share. Net proceeds to the Company from these sales were $678,589" and that such amounts received by the Company

had been recorded and reflected as "Additional Paid In Capital" without any factual basis for such statements and treatment; and such statements by Deloitte omitted to state or otherwise disclose in respect of such financial statements and the transactions reported therein that (i) no such arrangement existed whereby the Company received such funds "gratis" from such stockholder [Frank Lopez] as additional paid in capital, (ii) the receipt of such monies from such stockholder represented an advance or loan from the stockholder to the Company and should have been classified as such on the Company's financial statements, (iii) as an inducement for and in consideration of such transfer of funds by such stockholder, the Company had entered into an agreement with such stockholder requiring the Company to, among other things, issue shares of its authorized but unissued Common Stock to the stockholder for each share of the Company's Common Stock sold by such stockholder, the proceeds of which were received and transferred to the Company by such stockholder and that the Company had failed and refused to perform this and the other agreements it made with such stockholder resulting in an actual or contingent liability of and by the Company to such stockholder in respect of such funds transfer and the agreements attending such transfer and that (iv) the subject agreements and funds transfer was the subject of a dispute and resulting litigation between the stockholder and the Company representing a threat to the Company's ability to operate as a going concern in the event such litigation should be decided in a manner adverse to the Company. Deloitte's reports and opinions stating that each of AVBC's 1990, 1991 and 1992 year-end financial statements were fairly presented "in conformity with generally accepted accounting principles" were otherwise fraudulent, false and misleading and negligent for the reasons alleged both herein and elsewhere in this Complaint.

VII.

OMISSIONS

30. During the Class Period, AVBC under the direction and control of the Management thereof knowingly, intentionally and recklessly concealed, failed and refused to report and disclose and otherwise omitted from statements and reports made to the public trading markets for AVBC's securities and to holders of such securities including the Plaintiffs, certain material information about AVBC's business, property, management, results of operations, financial condition and future prospects affecting and otherwise issued by the Company in connection with the purchases and sale of AVBC's securities, including without limitation the following:

(1) That Gillespie had been found to have committed bankruptcy fraud, was a convicted felon and that the Company and Gillespie had been previously ordered to cease and desist selling bottled water products in the State of Hawaii;

(2) That AVBC's standard form of "Master Distribution Agreement" contained a re-purchase (or buy-back) provision which required the Company to re-purchase all inventory previously sold by the Company to its distributors in the event of unilateral cancellation of such distributorship agreement by the distributor;

(3) That in April 1990, and again in April 1991, the Hawaii State Department of Health had issued cease and desist and product recall orders against the Company (KWC) due to product contamination;

(4) That in August 1991, Gillespie and Karban with the concurrence and assistance of Deloitte, had

cancelled and re-written promissory notes and otherwise caused AVBC to assume and pay a personal obligation of Gillespie in the amount of $81,638 arising from his prior purchase of shares of the Company's (KWC's) Common Stock from certain former shareholders of the Company;

(5) That at January 8, 1991 and thereafter, Gillespie held 2,400,000 shares of AVBC Common Stock in his name for the account and beneficial ownership of Kevin Woodbridge, and thereafter caused the Company to issue Woodbridge an additional 2,400,000 shares so Gillespie could retain ownership of such shares for his own personal account;

(6) That at December 31, 1991 and thereafter, Gillespie held 1,000,000 shares of AVBC Common Stock in his name for the account and beneficial ownership of T. Gordon Sim to conceal the direct ownership of such shares by Sim from the Company's shareholders, the public securities markets and Government regulatory authorities;

(7) That limited consumer taste tests conducted by the Company in November 1992 indicated that the Company's "flavor enhanced" products were not favorably perceived by consumers;

(8) That as early as December 1992, the Company's largest distributor (Golden Brands) had indicated its intentions to terminate its Master Distribution Agreement with AVBC and to return for re-purchase by the Company all of Golden Brands' previously purchased and unsold inventory of AVBC products in the approximate amount of $400,000;

(9) That by December 31, 1993, every distributor which had previously agreed to distribute the Company's products had terminated its Master Distribution Agreement with AVBC;

(10) That by December 31, 1993, distribution of the Company's products was limited to only two metropolitan areas (Los Angeles and Chicago) through the direct efforts of the Company;

(11) That Sim resigned his position as a Director of the Company because he was under investigation by the SEC for alleged insider trading in the stock of Clearly Canadian;

(12) That AVBC's projections of sales and profits in 1991, 1992 and 1993 were not based upon any reliable facts or information supporting such projections of sales and income;

(13) That AVBC did not actually plan to and never did introduce its "Aqua" bacteria free water for sale even though Gillespie had publicly announced that AVBC had received $40 million in sales orders for such product;

(14) That the Company was under capitalized and could not support its operations through the sale of its products and was dependent upon the proceeds from the sale by Gillespie and others of unregistered shares of the Company's stock to support the Company's business and operations;

(15) That in 1991 Gillespie had converted for his own personal benefit the Company's opportunity and agreement to sell shares of its authorized but unissued shares of Common Stock to one or more executives of Golden Brands;

(16) That the Company's payable to Gillespie as reflected on the Company's financial statements and books and records commencing in 1991 was substantially

inflated as a result of the usurpation of corporate opportunities by Gillespie;

(17) That in the summer of 1991 the Company had offered and sold an issuance of convertible debt securities without registration under federal or state securities laws and without an exemption from such registration requirements resulting in a contingent liability to the Company of approximately $1.5 million;

(18) That in 1992 Gillespie, Mullen and Karban had back-dated the purported issuance of 2.5 million free "employee bonus" shares to themselves to early in 1991, and had otherwise failed to properly account for such employee compensation transaction, thereby overstating the ownership of shares of the Company's Common Stock by such Defendants and/or understating expenses of the Company attributable to the issuance and sale of such employee bonus shares by approximately $10 million;

(19) That Gillespie and Karban had each purchased and sold shares of the Company's Common Stock within a six month period of time in 1993 in violation of the "insider trading" provisions of Section 16(b) of the Securities Exchange Act, and that the Company was entitled to recover the profits attributable to such insider trading transactions by Gillespie and Karban in the approximate amount of $390,000;

(20) That by as early as September 30, 1991, the Company lacked the financial resources to pay its current obligations as they came due, including in respect of the repayment of the funds advanced by Lopez to the Company through August of 1991, and that the Company was thus "insolvent";

(21) That in 1994, when the Company was announcing the national introduction of a new line of "functional" bottled water products, the Company lacked the financial resources to introduce, offer, sell and promote a new line of beverage products on a national or even a regional basis;

(22) That in 1994, when the Company was announcing the national introduction of a new line of "functional" bottled water products, the Company lacked a distribution network or capability for the offer, sale and distribution of such new line of beverage products;

(23) That the Company never met the financial requirements for acceptance of the Company's Common Stock on the National Association of Securities Dealers' Automated [National Market] Quotation System ("NASDAQ");

(24) That the Company's application for inclusion or "listing" on the NASDAQ's National Market was denied and, based thereon, the Company withdrew its application for such NASDAQ listing in the summer of 1993;

(25) That the Company's 1990, 1991 and 1992 year-end financial statements, as audited and reported upon by Deloitte, were not prepared in accordance with GAAP and were otherwise deficient in the following, among others, material respects:

(i) Deloitte was not "independent" because Deloitte not only audited the Company's 1990 and 1991 financial statements but Deloitte actually drafted and otherwise prepared the Company's financial statements which they purported to audit in their

capacity as AVBC's independent outside accountants and auditors;

(ii) The Company's 1991 audited financial statements did not disclose any contingent liability attributable to sales of the Company's bottled water products to the Company's distributors under distributorship agreements which allowed the distributors to terminate such distributorship arrangement and to re-sell all AVBC products previously purchased by such distributors to the Company;

(iii) The Company's 1992 audited financial statements overstated sales revenues and did not disclose any contingent liability attributable to sales of the Company's bottled water products to the Company's distributors under distributorship agreements which allowed the distributors to terminate such distributorship arrangement and to re-sell all AVBC products previously purchased by such distributors to the Company;

(iv) The Company's 1991 audited financial statements overstated the Company's liability to Gillespie in the approximate amount of $116,000 in that such payable was attributable to the offer and sale of the Company's securities by Gillespie instead of the Company which opportunity Gillespie had usurped from the Company following the agreement and documentation of such transaction to involve the sale of such shares by and for the account of the Company;

(v) The Company's 1991 (and/or 1992) audited financial statements understated employee compensation expenses attributable to the 2.5 million

shares of free "employee bonus" shares that Gillespie, Mullen and Karban caused the Company to issue to them in 1992 but back dated to January of 1991 (immediately prior to the existence of a public trading market for shares of the Company's Common Stock);

(vi) The Company's 1992 audited financial statements understated employee compensation expenses attributable to the 2.1 million shares of "employee bonus" stock that Gillespie, Mullen and Karban caused the Company to issue to themselves and other officers/directors in 1992 in the amount of $3.2 million (as previously acknowledged by the Company and its auditors on or about June 7, 1993);

(vii) The Company's 1990, 1991 (and/or 1992) audited financial statements overstated AVBC's liability described as a "working capital loan" because such "loan" was in reality Gillespie's personal debt which he, aided and assisted by Karban and Deloitte, had caused AVBC to assume.

(viii) The Company's 1991 and 1992 audited financial statements did not report or otherwise disclose the Company's liability to Frank Lopez for the $680,000 in funds advanced by Lopez to the Company to be used as working capital and/or the Company's failure and refusal to perform its agreements and other obligations to Lopez which constituted and comprised such Lopez transaction;

(ix) The Company's 1992 audited financial statements substantially understated the Company's liability to Golden Brands (approximately $95,000 at December 32, 1992) for the purchase by the Company of finished goods inventory (AVBC bottled water product)

manufactured for the account of and sold by Golden Brands and delivered to the Company in 1992;

(x) The Company's 1992 audited financial statements substantially understated the Company's liabilities including particularly in respect of the Company's obligation and agreement to repurchase defective

("brown" water) product sold by the Company to its distributors in the Summer of 1992 in the approximate amount of $1,000,000; and

(xi). The Company's 1990, 1991 and 1992 audited financial statements failed to report or otherwise disclose that the State of Hawaii had issued a cease and desist order enjoining the Company from the manufacture and/or sale of its Hawaii water product thereby preventing the Company from realizing any revenue from the sale of existing, and/or the manufacture of any future, such Hawaii water product; and requiring the Company to destroy and to write-off the value of all such Hawaii water product carried as inventory or otherwise on the Company's financial books and records.

VIII.

PERSONS WHO PARTICIPATED, ASSISTED AND AIDED AND ABETTED AND OTHERWISE CONSPIRED WITH AVBC AND ITS MANAGEMENT'S WRONGFUL AND ACTIONABLE CONDUCT

31. All of the Defendants identified above who served as or performed functions similar to those performed by such officers and/or directors of AVBC (herein

"Management") through such actions as described herein and otherwise to be proven at trial of this case participated, assisted and aided and abetted and otherwise conspired with AVBC, its Management's and each other's, wrongful and actionable conduct and activities as alleged herein.

32. Additionally, by their actions and conduct, Deloitte knowingly and intentionally participated, assisted and aided and abetted and otherwise conspired with AVBC and its Management in the making of fraudulent and otherwise false and misleading statements about AVBC and affecting the offer, sale, issuance, purchase, ownership and sale of AVBC's securities, as alleged herein, including without limitation in the following particular instances:

(1) Deloitte drafted and prepared the Company's 1990 and 1991 financial statements and thereafter purported to audit such financial statements as the Company's independent outside auditor.

(2) Deloitte issued reports and opinions on AVBC's audited financial statements which they knew and intended, or were extremely reckless in not knowing, were not accurate and complete in all material respects and/or were not in accordance with GAAP, including without limitation Deloitte's reports and opinions dated August 28, 1991, February 14, 1992 and March 11 and June 7, 1993 on AVBC's audited consolidated financial statements for the years ended and as at, December 31, 1990, 1991 and 1992. Deloitte participated in the preparation of and assisted AVBC and AVBC's Management to prepare, make and disseminate reports, financial statements, registration statements, prospectuses, press releases and other written communications to AVBC's securities holders/investors and to the public trading markets for such securities which Deloitte knew, or was extremely reckless in not knowing, were not accurate and

complete in all material respects including without limitation AVBC's 1991 and 1992 Annual Reports to the SEC on Form 10-K.

(3) As previously described herein at para.'s 9 and 20, during the course of its audit of AVBC's (KWC's) financial statements for the year ended and as at December 31, 1990 Deloitte advised, assisted, aided and assisted and conspired with Gillespie and Karban to cause AVBC to assume and pay Gillespie's personal debt and obligation in the minimum amount of $81,638.

(4) As previously described herein at para. 20, during the course of its audit of AVBC's financial statements for the year ended and as at December 31, 1991, Deloitte advised, assisted, aided and abetted and conspired with Gillespie, Mullen and Karban (the so-called Entrepreneurial Team) to back-date the issuance of and to materially understate the value and resulting expense to the Company of purported 2.5 million share stock grant to such Defendants (without the receipt of any consideration for the issuance of such shares of the Company's stock as required under Delaware law), resulting in a $10 understatement of the loss attributable to such period (or in 1992) and the failure to report and warn the Company's securities holders in respect of such wrongdoing and the increased likelihood of future wrongdoing by such Entrepreneurial Team to the substantial detriment, harm and prejudice to such securities holders.

(5) As previously described in para. 20, during the course of its audit of AVBC's financial statements for the year ended and as at December 31, 1992, Deloitte advised, assisted, aided and abetted and otherwise conspired with AVBC, Gillespie, Mullen and Karban to understate the value and resulting expense to the Company in respect of stock compensation awards to such Defendants and other AVBC

employees, resulting in a $3 million understatement of AVBC's loss for such period.

(6) As previously described herein at para. 20, during the course of its audit of AVBC's financial statements for the years ended and as at December 31, 1992 and 1991, Deloitte advised, assisted, aided and abetted and otherwise conspired with AVBC and its Management to conceal the fact that all of AVBC's master distributors had the unilateral right to cause AVBC to re-purchase AVBC's product previously sold by AVBC to such distributors and thereby to overstate the Company's sales revenue and/or to understate the Company's contingent and actual liabilities attributable to such previously sold but returnable product.

(7) As previously described in para. 20, during the course of its audit of AVBC's financial statements for the year ended and as at December 31, 1992, Deloitte advised, assisted, aided and abetted and otherwise conspired with to substantially understate the Company's liabilities for such period including without limitation the $95,000 which the Company owed to Golden Brands for the purchase of finished goods inventory of the Company's product from Golden Brands in 1992 (including by not sending Golden Brands a written request for confirmation of the amount of the debt due and owing by the Company to Golden Brands at December 31, 1992 in respect of such product).

FIRST CAUSE OF ACTION
AGAINST ALL DEFENDANTS
FEDERAL SECURITIES LAWS VIOLATIONS
(Section 10(b) and Rule 10b-5)

33. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

34. The false and misleading statements and the omissions as alleged herein constitute violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 77a et seq., and Rule 10b-5(b) promulgated thereunder, 17 C.F.R. § 240.10b-5(b).

35. The Plaintiffs relied upon the false and misleading statements as alleged herein and upon the fact that the public market price for the Company's securities was "efficient" and therefore reflected a reasonably accurate representation of the value of such securities unaffected by the public dissemination of any false and/or misleading statements and information or the omission of any material information regarding AVBC, its business operations and prospects, management of the Company and financial condition of the Company (i.e., no "fraud on the market").

36. Additionally, AVBC and the AVBC Management Defendants named herein, having issued public statements, reports and assurances regarding AVBC's business, financial condition, prospects, anticipated revenues and profitability and affairs were under a duty to correct any and all of such previously issued statements at such time that the Defendants knew or were reasonably aware, or should have been aware, that such previously issued statements were no longer accurate and that the Company's shareholders and persons in the investment community were continuing to rely upon the accuracy of such statements in formulating their decisions to purchase or sell the Company's securities.

37. As alleged herein, AVBC and the AVBC Management Defendants made false and misleading public statements including projections as to AVBC's future sales and profits then, after such Defendants were aware, or should have been aware, that such statements/projections were no longer accurate and should have been withdrawn and/or updated or

otherwise corrected. Such Defendants took no action to cure or otherwise ameliorate the affect of such false and misleading statements.

38. AVBC and the AVBC Management Defendants failed and refused to withdraw and/or update or otherwise correct previously issued public statements including projections of AVBC's sales and profits which because of the passage of time or otherwise had become materially false or misleading and were affecting or were likely to affect ongoing trading in the Company's securities.

39. AVBC and the AVBC Defendants failed and refused to withdraw and/or update or otherwise correct previously issued public statements of a material nature which such Defendants knew, or were extremely reckless in not knowing, were or had become false or misleading as alleged herein in violation of such Defendants' duties and responsibilities under, and in contravention of, Section 10(b) and Rule 10b-5 of the Securities and Exchange Act.

40. As a result of the false and misleading statements and the omissions, and the failure to timely withdraw and/or update or otherwise correct previously issued statements which had subsequently become false or misleading as alleged herein, Plaintiffs have been directly and proximately injured and damaged thereby in the purchase or sale of the securities of AVBC and as more particularly alleged elsewhere in this Complaint; and the Defendants, and each of them, are legally responsible for the Plaintiffs' damages.

SECOND CAUSE OF ACTION
AGAINST DEFENDANT KARBAN
INSIDER TRADING
FEDERAL SECURITIES LAW VIOLATIONS
(Sections 10(b) and 20A)

41. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

42. As alleged in para.'s 13 and 30(19), and elsewhere in the Complaint, Defendant Karban sold shares of the Company's Common Stock while in the possession of materially adverse, non-public information about the Company and the value of its securities, without first publicly disclosing such information including to contemporary purchasers of the shares of AVBC stock sold by Defendant Barker, and Defendant Barker thereby engaged in "insider trading" in violation of applicable federal securities laws including without limitation under Section 10(b) and SEC Rule 10b-5, and Section 20A, of the Securities Exchange Act of 1934.

43. During the period January 1993 through June 1993, and thereafter, Defendant Karban sold 50,000 or more shares of AVBC stock in the public trading market for such shares while in possession of material, non-public information including without limitation the Company's undisclosed liabilities pertaining to the repurchase of defective product sold to distributors in the Summer of 1992, the Company's agreement to repurchase such product from distributors, the reporting of fictitious sales by the Company for the Quarter ended March 31, 1993 constituting the substantial majority of all sales reported by the Company for such period, the Company's non-receipt of payment for the sale of stock previously reported as stock subscriptions received into the Company's capital account and the resulting insolvency of the Company.

44. Defendant Karban received approximately $200,000 from the sale of such AVBC stock to members of the Class who were the contemporaneous purchasers of the stock sold by Defendant Karban while in possession of such materially adverse, non-public information as alleged herein; and all of such proceeds constituted Defendant Karban's gain ("Profits") from the sale of such stock (since Karban had received the stock from the Company for free).

45. Members of the Class, who were the contemporaneous purchasers of the stock of the Company sold by Defendant Karban, were not in a position to know and, on information did not know, about any of the material adverse information known to Defendant Karban at the time she sold such stock.

46. The facts upon which the instant claim for insider trading were alleged in the initial complaint filed in this action; and, in any event, the within claim is made within five (5) years from the date of the last insider sale transaction by Defendant Karban as alleged herein as the basis for such claim.

47. If any of the other Defendants named in this action are found to have sold shares of the Company's stock to the Plaintiffs and/or any members of the Class who were the contemporaneous purchasers of such AVBC stock, then the Plaintiffs and the Class hereby expressly reserve the right to amend this Complaint at any time before or during the course of the trial of this action to assert a claim for insider trading against any one or more of such Defendants under this cause of action.

48. As part of the within cause of action and relief requested in respect thereof, the Plaintiffs for and on behalf of the Class, who were the contemporaneous purchasers

of the AVBC stock sold by Defendant Karban while in possession of inside information as alleged herein, are entitled to recover and otherwise obtain and receive from Defendant Karban and her depositories, agents, attorneys, representatives, custodians, designees, transferees and successors-in-interest whether by operation of law or otherwise (collectively the "Karban Transferees") the Profits (including any and all assets or other property purchased or otherwise acquired, obtained and/or received by, for or on behalf of Karban from the proceed of the sale of such AVBC stock referred to herein collectively as the "Profits") realized, obtained, received or otherwise available to Defendant Karban from and otherwise attributable to or in respect of the sale of such AVBC stock by Karban.

49. A constructive trust should be imposed against and upon Defendant Karban and the Karban Transferees, and each of them, and on and otherwise in respect of the Profits including requiring Defendant Karban and/or the Karban Transferees to turn over any and all such Profits to counsel of record for the Class or such other person or entity which the Court may designate for purposes of such constructive trust to hold, preserve and protect such Profits for subsequent transfer and distribution to the members of the Class who were the contemporaneous purchasers of the AVBC stock sold by Defendant Karban if the Class is ultimately determined to be the prevailing party in respect of the within claim for insider trading.

THIRD CAUSE OF ACTION
AGAINST THOMAS J. GILLESPIE
AND MARIE MULLEN GILLESPIE
FOR CONTROLLING PERSON LIABILITY
(Section 20 of the Securities Exchange Act)

50. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

51. Thomas J. Gillespie, by virtue of his and his wife's ownership of a majority of the Company's issued and outstanding Common Stock and his position as the Chairman of the Board, Chief Executive Officer and President of the Company and the resulting power and authority to manage the business and affairs of the Company, and his involvement in the day-to-day operations and management of the Company and his status as a substantial lender to and creditor of the Company, is and was during the period covered by this Complaint a controlling person of the Company as that term is defined under and for purposes of Section 20 of the Securities Exchange Act.

52. Marie Mullen Gillespie, by virtue of her and Tom Gillespie's ownership of a controlling block of shares of the Company's Common Stock and her position as Vice President-Design and a director of the Company, her resulting power and authority to manage the business and affairs of the Company and her involvement in the day-to-day operations and management of the Company, is and was during the period covered by this Complaint a controlling person of the Company as that term is defined under and for purposes of Section 20 of the Securities Exchange Act.

53. Together, as husband and wife, Thomas J. Gillespie and Marie Mullen Gillespie were

controlling persons of the Company as that term is defined and for purposes of Section 20 of the Securities Exchange Act.

54. As controlling persons under Section 20 of the Securities Exchange Act, Thomas J. Gillespie and Marie Mullen Gillespie are jointly and severally responsible and liable to the Plaintiffs for the Company's federal securities violations as alleged herein.

FOURTH CAUSE OF ACTION
AGAINST ALL DEFENDANTS
STATE SECURITIES LAW VIOLATIONS
(Idaho Sec. Act §§ 30-1403, 1442 & 1446)

55. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

56. The false and misleading statements and the omissions, including the failure to withdraw and/or update or otherwise correct previously issued public statements including projections as to sales and profits which had by the passage of time or otherwise subsequently become false or misleading as alleged herein, constitute

violations of Sections 30-1404(1), (2) and (3), and 1442(3) and 1446, of the Idaho Securities Act ("ISA").

57. As a result of the false and misleading statements and the omissions, and the failure to timely withdraw and/or update or otherwise correct previously issued statements which had subsequently become false or misleading as alleged herein, Plaintiffs and the Class have been directly and proximately injured and damaged thereby in the purchase or sale of the securities of AVBC and as more particularly alleged elsewhere in this Complaint; and the Defendants, and

each of them, are legally responsible for the Plaintiffs and the Class' damages.

58. The Plaintiffs and the Class relied upon the false and misleading statements as alleged herein and upon the fact that the public market price for the Company's securities was "efficient" and therefore reflected a reasonably accurate representation of the value of such securities unaffected by the public dissemination of any false and/or misleading statements and information or the omission of any material information regarding AVBC, its business operations and prospects, management of the Company and financial condition of the Company (i.e., no "fraud on the market").

59. Among the false and misleading statements received, read and otherwise relied upon by the Plaintiffs and the Class in determining to purchase the Company's securities, as alleged herein, includes without limitation the representation, statement, projection and assurance by the Company that the Company's sales in 1991 would be $15-20 million and that profits for such period would be approximately $5 million.

60. The Plaintiffs and/or the Class purchased AVBC stock sold by Defendants Karban, Gillespie and others, and were otherwise in privity with such selling Defendants.

61. As a result of the wrongful actions and conduct of the Defendants as alleged herein, the Plaintiffs and the Class have been directly and proximately injured and damaged thereby, as more particularly described elsewhere in this Complaint, in an amount to be proven at trial.

FIFTH CAUSE OF ACTION
AGAINST ALL DEFENDANTS
AIDING AND ABETTING
STATE SECURITIES LAW VIOLATIONS
[Idaho Sec. Act § 30-1442(3) and/or 1446(b)(2)]

62. Paragraphs 1 through 32, and 56 through 61, are realleged and incorporated by reference herein.

63. Each of the Defendants knowingly conspired, cooperated with, assisted and substantially aided and abetted each of the other Defendants in the state securities laws violations alleged in the Plaintiffs' Fourth Cause of Action thereby rendering each of the Defendants legally responsible to the Plaintiffs and the Class for damages as more particularly described elsewhere in this Complaint.

64. The AVBC Management Defendants and each of them had actual or constructive knowledge of the violations of the Idaho Securities Act which are alleged in the Fourth Cause of Action; and such Defendants, having participated in making the violations possible or having had actual or constructive knowledge of such violations while acting as an officer and/or director of the Company, are liable to the Plaintiffs and the Class for having aided and abetted such violations by AVBC and the AVBC Management under ISA Sections 30-1442(3) and/or 1446(b)(2).

SIXTH CAUSE OF ACTION
AGAINST THOMAS J. GILLESPIE
AND MARIE MULLEN GILLESPIE
FOR CONTROLLING PERSON LIABILITY
(Cal. Corp. Sec. Law § 25504)

65. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

66. Thomas J. Gillespie, by virtue of his and his wife's ownership of a majority of the Company's issued and outstanding Common Stock and his position as the Chairman of the Board, Chief Executive Officer and President of the Company and the resulting power and authority to manage the business and affairs of the Company, his involvement in the day-to-day operations and management of the Company and his status as a substantial lender to and creditor of the Company, is and was during the period covered by this Complaint a controlling person of the Company as that term is defined under and for purposes of Section 25504 of the CSL.

67. Marie Mullen Gillespie, by virtue of her and Tom Gillespie's ownership of a controlling block of shares of the Company's Common Stock and her position as Vice President -Design and a director of the Company, her resulting power and authority to manage the business and affairs of the Company and her involvement in the day-to-day operations and management of the Company, is and was during the period covered by this Complaint a controlling person of the Company as that term is defined under and for purposes of Section 25504 of the CSL.

68. Together, as husband and wife, Thomas J. Gillespie and Marie Mullen Gillespie were controlling persons of the Company as that term is defined and for purposes of Section 25504 of the CSL.

69. As controlling persons under Section 25504 of the CSL, Thomas J. Gillespie and Marie Mullen Gillespie are jointly and severally responsible and liable to the Plaintiffs for the Company's state securities violations as alleged herein.

SEVENTH CAUSE OF ACTION
AGAINST ALL DEFENDANTS
FOR FRAUD
(Pendent State Claim Under Idaho Law)

70. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

71. As alleged elsewhere herein, the Defendants and each of them made one or more statements of material fact to the Plaintiffs and the Class knowing that such statement was not true and intending that the Plaintiffs and the Class rely upon such statements of material fact in determining to purchase and hold securities of AVBC.

72. The Plaintiffs relied upon the false and misleading statements as alleged herein and upon the fact that the public market price for the Company's securities was "efficient" and therefore reflected a reasonably accurate representation of the value of such securities unaffected by the public dissemination of any false and/or misleading statements and information or the omission of any material information regarding AVBC, its business operations and prospects, management of the Company and financial condition of the Company (i.e., no "fraud on the market"); and when the Defendants made the false and misleading statements concerning AVBC stock alleged herein they knew and intended that such statements were directed to the Company's securities holders as a group and that such false and misleading statements would be received by such group and otherwise by the public market for AVBC stock and that the price for AVBC stock as determined by such public trading market would be relied by the Plaintiffs and the Class in determining to purchase AVBC stock so that the false and misleading statements by the Defendants would thereby be further communicated to and relied upon by the Plaintiffs and the

Class in the form of the quoted market price for AVBC securities representing a fair and reasonable price for the Plaintiffs and the Class to pay for such securities.

73. The Plaintiffs and the Class received and relied upon such intentional misrepresentation in determining to purchase and hold securities of AVBC.

74. The Plaintiffs and the Class were not aware, and under reasonable diligence would not be expected to be aware, that intentional misrepresentations by each of the Defendants were not true and accurate as represented.

75. As the direct and proximate result of the Defendants intentional misrepresentations, the Plaintiffs and the Class were injured and damaged in an amount to be proven at trial.

76. Defendants' intentional misrepresentations were made with fraud, oppression and malice so as to entitle Plaintiffs and the Class to punitive or exemplary damages against the Defendants and each of them in an amount to be determined at trial.

77. Among the intentional misrepresentations made by the Defendants to the Plaintiffs and the Class was the representation, statement, projection and assurance that the Company's sales would be $15-20 million in 1991 and that profits for such period would be approximately $5 million.

EIGHTH CAUSE OF ACTION
AGAINST ALL DEFENDANTS
CONSTRUCTIVE FRAUD AND DECEIT
(Pendant State Claim Under Idaho Law)

78. Paragraphs 1 through 32, and 97 through 105, are realleged and incorporated by reference herein.

79. The AVBC Management Defendants and each of them owed Plaintiffs and the Class fiduciary and other special duties of trust and confidence.

80. Deloitte, as AVBC's independent outside accountant and auditor, owed the Plaintiffs and the Class fiduciary and other special duties of trust and confidence.

81. Deloitte, as AVBC's independent outside accountant and auditor, was in a special relationship with the Plaintiffs and the Class.

82. As a result of such fiduciary and other special duties, and special relationship, the Defendants owed the Plaintiffs and the Class an affirmative duty of disclosure regarding facts and circumstances pertaining to such Plaintiffs and the Class' ownership of AVBC securities.

83. As alleged herein, the Defendants failed and refused to provide the Plaintiffs and the Class with information regarding their ownership of AVBC securities which the Defendants knew or reasonably should have known would be material to such persons' decision to buy, sell or hold such securities.

84. As a direct and proximate result of such failure to affirmatively disclose to Plaintiffs and the Class material information regarding such persons' ownership of AVBC securities and the resultant constructive fraud and deceit by the Defendants, the Plaintiffs and the Class were directly and proximately injured in an amount to be proven at trial.

85. Defendants' constructive fraud and deceit, including the active cover-up and concealment by the Defendants of material facts pertaining to the Plaintiffs and the Class' ownership of AVBC securities, was the result of fraud, oppression and malice by the Defendants and each of them so as to entitle Plaintiffs and the Class to punitive or exemplary damages against the Defendants and each of them in an amount to be determined at trial.

NINTH CAUSE OF ACTION
AGAINST ALL DEFENDANTS
NEGLIGENT MISREPRESENTATION
(Pendent State Claim Under Idaho Law)

86. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

87. As a result of their actions and conduct as alleged herein, the Defendants and each of them made and/or caused to be made certain statements and representations to Plaintiffs and the Class which such Defendants knew, or should have known after reasonable inquiry and therefore were careless in not knowing at the time of making such statements and representations, were false or misleading and constituted actionable misrepresentations.

88. The Defendants, in making or causing to be made such false or misleading statements, intended or reasonably should have known that the Plaintiffs and the Class would receive and rely thereon in formulating investment

decisions regarding, among other things, the purchase, holding and/or sale of AVBC's securities.

89. Plaintiffs and the Class received and relied upon such false or misleading statements as made by the Defendants, and were directly and proximately injured and damaged thereby as more particularly described elsewhere in the Complaint.

TENTH CAUSE OF ACTION
AGAINST AVBC AND AVBC MANAGEMENT
BREACH OF FIDUCIARY DUTY

(Pendent State Claim Under Delaware Law)

90. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

91. AVBC and the AVBC Defendants, and each of them, by virtue and as a result of the positions of trust and confidence they held with AVBC, and as a matter of statutory and/or common law under Delaware law which is the State of incorporation of AVBC and where the Company was organized and exists by virtue of the powers and the laws of such State, were in a fiduciary relationship with and owed fiduciary duties of care, loyalty and truthfulness to AVBC and its securities holders including the Plaintiffs and the Class.

92. AVBC and the AVBC Defendants, and each of them, by virtue and as a result of the positions of trust and confidence they held with AVBC, and as a matter of statutory and/or common law in Delaware, were in a fiduciary relationship with and owed fiduciary duties of care, loyalty and truthfulness to AVBC and the holders of its Common Stock, warrants to purchase Common Stock and convertible

debentures (convertible by the holders thereof into Common Stock of the Company) including the Plaintiffs and the Class.

93. Further, in light of the fact that AVBC was insolvent during the operative period covered this Complaint, AVBC and the AVBC Management Defendants and each of them, as a matter of Delaware statutory and/or common law, owed fiduciary or other special duties of care, loyalty and truthfulness to AVBC's creditors including the members of the Class who owed the Company's debentures.

94. The Defendants, and each of them, failed to timely and properly inform the Plaintiffs and the Class in respect of the true business and/or financial affairs and condition of AVBC (motivated, in substantial part, by such Defendants' desire to maintain and perpetuate their own titles, offices, positions, employment and relationships (contractual and otherwise) with the Company and the financial and other benefits accruing to such parties as a result thereof.

95. The actions of the Defendants, and each of them as alleged herein, constituted a breach of such Defendants' fiduciary duties of care, loyalty and truthfulness to AVBC and to the Class including the Plaintiffs.

96. The Plaintiffs and the Class were directly and proximately injured and damaged by the actions of the Defendants, and each of them, as alleged and more fully described elsewhere in this Complaint, in amounts to be proven at trial.

ELEVENTH CAUSE OF ACTION
AGAINST ALL OF THE DEFENDANTS
FOR NEGLIGENCE
BASED ON A SPECIAL RELATIONSHIP
(Pendant State Claim Under Idaho Law)

97. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

98. Under the laws of the State of Delaware, where the Company was organized and exists by virtue of the powers and laws of such State, the AVBC Management Defendants, who were directors and officers (or performed functions similar thereto) of the Company, owed fiduciary and other special duties to the Company's securities holders including the Plaintiffs and the Class.

99. The AVBC Management Defendants were in a special relationship with the Company's securities holders including the Plaintiffs and the Class as a result of the status of such persons as fiduciaries for AVBC and its securities holders.

100. Included among the duties owed by the AVBC Management Defendants to the Plaintiffs and the Class, as a result of their ownership of the Company's securities and otherwise, were the duties of care, loyalty and truthfulness which imposed upon such Defendants the obligation, among others, to keep themselves regularly and adequately informed as to the business and affairs of the Company and to promptly report to the Company's securities holders information which such Defendants reasonably knew the Plaintiffs and the Class would want to know in timely determining to sell, hold or otherwise deal in the securities of the Company owned by such persons.

101. Defendant Deloitte held its self out as a licensed expert in the field of accounting and auditing and, in accepting the engagement to audit and report upon the Company's financial statements to the Company's securities holders, and to otherwise assist the Company with matters of a accounting and financial nature including the preparation of periodic reports including financial statements to the SEC, the Company's securities holders and the public trading market for such securities, Deloitte was in a special relationship with the Company and its securities holders including the Plaintiffs and the Class and owed the Company and such group of persons duties of professional care, loyalty and truthfulness, including without limitation to competently perform audits and issue reports and opinions on the Company's 1990, 1991 and 1992 year-end financial statements.

102. In performing audits of the Company's financial statements and in issuing reports and opinions thereon to the Company's securities holders and the public market for such securities, and in otherwise performing accounting and financial services for the Company as alleged herein, Deloitte failed and refused to use professional due care and to timely, accurately and completely report to the Company's securities holders as to the matters which were the subject of Deloitte's services and/or reports and opinions to the Company and its securities
holders.

103. As alleged herein, the Defendants and each of them breached such duties of care and failed and refused to carefully and honestly report to the Company's securities holders on a timely basis as to matters which the Defendants knew, or with the exercise of reasonable care should and would have known, were important to the holders of the Company's securities relative to their investment in such securities; and, in breach of such duties, the Defendants issued

false and misleading reports to the Company's securities and otherwise failed to keep the Company's securities holders informed as to material matters pertaining to the Company and the Plaintiffs and the Class' investments therein.

104. The Defendants and each of them owed a duty to the Plaintiffs and the Class to timely disclose all information which they reasonably understood was likely to affect the price of the Company's securities in order to prevent such securities holders from suffering a loss attributable to their ownership of the Company's securities as a result of financial or other information provided by the Defendants to or otherwise affecting the Plaintiffs and the Class - - whether provided directly to such securities holders or indirectly through such information's affect on the market price of the Company's securities.

105. In accepting positions as officers/directors of the Company, and in accepting engagements to act and serve as the Company's independent accountant and auditor, and in purporting to perform such positions and services for the benefit of the Company and its securities holders, the Defendants induced reliance by the Plaintiffs and the Class in their ability to perform such positions and services for the Company and its securities holders and the Plaintiffs and the Class did therefore reasonably rely upon the Defendants to perform services and otherwise act for the Company in a manner consistent with such Defendants' special duties and relationship to the Company and all of its securities holders.

106. As a result of such breach of duty by the Defendants and each of them, the Plaintiffs and the Class were directly and proximately injured and damaged in amounts to be proven at trial.

REQUEST FOR RELIEF

WHEREFORE, the Plaintiffs pray for judgment and other relief on the Complaint, as follows:

1. On the First Cause of Action (Federal Securities Law Violations under Section 10(b) and Rule 10b-5 Against All Defendants), damages according to proof at trial and interest, including prejudgment interest, thereon.

2. On the Second Cause of Action (Federal Securities Law Violations under Section 10(b)/Rule 10b-5 and Section 20A Against Defendant Karban), damages according to proof at trial and interest, including prejudgment interest, thereon; and, prior to the final adjudication of the claims constituting and comprising this Cause of Action, a constructive trust imposed and maintained on the Profits realized by Defendant Karban from the insider trading alleged in such Cause of Action.

3. On the Third Cause of Action (For Controlling Person Liability Against Thomas J. Gillespie and Marie Mullen Gillespie), damages according to proof at trial and interest, including prejudgment interest, thereon.

4. On the Fourth Cause of Action (For State Securities Law Violations Against All Defendants), damages according to proof at trial and interest, including prejudgment interest, thereon.

5. On the Fifth Cause of Action (For Aiding and Abetting State Securities Violations Against All Defendants), damages according to proof at trial and interest, including prejudgment interest, thereon.

6. On the Sixth Cause of Action (For Controlling Person Liability Under State Securities Laws Against Thomas J. Gillespie and Marie Mullen Gillespie), damages according to proof at trial and interest, including prejudgment interest, thereon.

7. On the Seventh Cause of Action (For Fraud and Deceit Against All Defendants), damages according to proof at trial, interest thereon including prejudgment interest, costs of suit including reasonable attorneys' fees and costs and exemplary and/or punitive damages.

8. On the Eighth Cause of Action (For Constructive Fraud and Deceit Against All Defendants), damages according to proof at trial, interest thereon including prejudgment interest, costs of suit including reasonable attorneys' fees and costs and exemplary and/or punitive damages.

9. On the Ninth Cause of Action (Negligent Misrepresentation Against All Defendants), damages according to proof at trial and interest, including prejudgment interest, thereon.

10. On the Tenth Cause of Action (For Breach of Fiduciary Duty Against AVBC and the AVBC Management Defendants), damages according to proof at trial, interest thereon including prejudgment interest, costs of suit including reasonable attorneys' fees and costs and exemplary and/or punitive damages.

11. On the Eleventh Cause of Action (Negligence Based On Special Relationship Against All Defendants), damages according to proof at trial and interest, including prejudgment interest, thereon.

And, unless otherwise specifically requested above, cost of suit, together with such other and further relief as the Court shall determine is fair, just and appropriate under the facts and circumstances of this case.

Dated: July 5, 1996

Respectfully submitted,

ROBERT H. BRETZ, P.C.

By: /s/
Robert H. Bretz,
Co-Counsel for Plaintiffs

DEMAND FOR JURY TRIAL

Plaintiffs, and each of them, hereby demand trial by jury pursuant to Rule 38(b) of the Federal Rules of Civil Procedure.

Dated: July 5, 1996

Respectfully submitted,
ROBERT H. BRETZ, P.C.

By: /s/ ROBERT H. BRETZ
Robert H. Bretz,
Co-Counsel for Plaintiffs

Supreme Court, U.S.
FILED
JAN 21
CLERK

No. 99-742

IN THE
Supreme Court of the United States

ALBERT AND ESTELLE BINDER, in their individual capacities and on behalf of all persons similarly situated,

Petitioners,

v.

IAN R. WILSON, CARY S. FITCHEY, MARK L. STEVENS and DELOITTE & TOUCHE LLP,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENT DELOITTE & TOUCHE LLP

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STATEMENT PURSUANT TO RULE 29.6

Rule 29.6 of the Rules of This Court does not apply to Respondent Deloitte & Touche LLP because it is a limited liability partnership and not a nongovernmental corporation.

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4 Bromberg & Lowenfels, *Securities Fraud and Commodities Fraud* § 8.6 (1988) 19

PRELIMINARY STATEMENT

Contrary to petitioner's arguments, the majority opinion of the Ninth Circuit Court of Appeals in *Binder v. Gillespie*, Order and Opinion dated July 26, 1999 (Appendix ("App.") A) (the "Binder Decision"), does not conflict with Supreme Court precedent.[1] The Binder Decision, moreover, does not raise questions of national importance, and certainly does not "affect the substantial number of Rule 10b-5 securities and other class action cases processed by the courts each year, the efficient system-wide administration of such cases and continued implementation of the anti-fraud purposes and objectives of the federal securities laws." Petition for Writ of Certiorari ("Petition") at 16. The Binder Decision also does not conflict with the decisions of other Circuit Courts. Rather, the Binder Decision represents the application of well-developed legal principles to the indisputable facts in a single case. Therefore, the Binder Decision does not warrant review by this Court.

The Ninth Circuit thoroughly examined the relevant legal authority, reviewed the undisputed evidence, and then affirmed the district court's conclusions that: (1) the *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153 (1972), presumption of reliance, "involving primarily a failure to disclose," is not applicable *in this case*; (2) petitioner failed to meet his burden of adducing facts to rebut the showing that the "over-the-counter" ("OTC") market for the stock of Aqua Vie Beverage Corporation ("AVBC" or "the Company"), the "pink sheet" security at issue in this lawsuit, was not efficient; and (3) petitioner could not establish, as a matter of law, that respondents made

1. The opinion is reported at 184 F.3d 1059 (9th Cir. 1999).

any material misrepresentations or omissions that caused any losses for the putative class over the period when AVBC stock was traded on the Boston Stock Exchange ("BSE"). Petitioner offers no legitimate reason to disturb these well-founded conclusions.

Notwithstanding petitioner's argument that this case will affect a "substantial number" of Rule 10b-5 cases, no published decisions have cited the Binder Decision — much less suggested that the Binder Decision somehow calls for a result different than what follows from pre-existing caselaw. The Ninth Circuit panel that handed down the Binder Decision, moreover, entertained, and rejected, similar apocalyptic arguments made by petitioner here when it voted to deny his petition for a rehearing. Order and Opinion dated July 26, 1999 (App. A at 7a). Additionally, no active judge sitting on the Ninth Circuit voted to grant petitioner's request for rehearing *en banc*. Order and Opinion dated July 26, 1999 (App. A at 8a). Implicit in the Ninth Circuit's denial of rehearing and rehearing *en banc* is the recognition that the Binder Decision conflicts with *no* decision of the Supreme Court and involves *no* question of exceptional importance. Given this, respondent Deloitte & Touche LLP ("Deloitte") respectfully requests that the Supreme Court also deny the Petition for Writ of Certiorari.

STATEMENT OF THE CASE

I. Objection to Petition

Pursuant to Rule 15.2 of the Supreme Court Rules, Deloitte objects to the "factual" presentation found in petitioner's Statement of the Case. Petitioner's Statement of the Case includes the recitation of countless "facts" that have

absolutely no bearing on the issues presented to this Court, and that are unsupported by the record presented to the Ninth Circuit Court of Appeals. The inclusion of these irrelevant facts also appears to violate Rule 14.3 of the Supreme Court Rules, which requires the Petition to be "stated briefly and in plain terms." Given the presentation made by petitioner, Deloitte is constrained to present the following facts that are relevant to it and the issues presented to this Court. It has attempted to keep that presentation as brief as possible so as not to further burden the Court, but cannot leave petitioner's unsupported assertions unrebutted.

II. The Facts Pertinent to Deloitte

In the early 1990's the "new age" beverage market was taking off. AVBC sought to enter that market by developing and selling bottled noncarbonated, lightly flavored spring water. Before 1991, AVBC's predecessor operating company, KWC, Inc., was privately held. In January 1991, as the result of a merger, AVBC became a public company. During 1991, when petitioner purchased stock in AVBC, and through most of 1993, AVBC's stock was traded on the OTC market. Sometime after December 1, 1993, trading of the Company's common stock commenced on the BSE.

AVBC's product never achieved any significant market success. As reported in the audited financial statements issued during the putative class period, AVBC had less than $240,000 in sales during 1991, and only approximately $1.3 million in sales during 1992. It operated at a reported loss every year. Further, it reported a negative net worth, which was in excess of $5,000 in 1991 and over $1.5 million in 1992.

Deloitte was first engaged in the summer of 1991 to audit AVBC's (KWC Inc.'s) 1990 financial statements. The 1990 financial statements were publicly disseminated for the first time on October 22, 1991, when they were included in an amendment to a Form 8 filed with the SEC. Thereafter, during the putative class period, Deloitte audited the annual financial statements of AVBC for the years ended December 31, 1991 and 1992. The audited 1993 financial statements were completed after the end of the putative class period.

The engagement letters executed by AVBC delineated the services to be performed by Deloitte. As stated by Jeff Stengel, the Deloitte manager in charge of the AVBC 1991 audit and the partner in charge of the 1992 and 1993 audits, Deloitte "never reviewed or had a business relationship with [AVBC] that we were engaged to review their 10-Q's." Deloitte did not review any unaudited or interim AVBC financial statements. AVBC financial projections, including those that appeared in the Management's Discussion and Analysis ("MD&A") section of the Company's 10-Q's, were prepared solely by AVBC personnel.

AVBC was a development stage enterprise as defined by Generally Accepted Accounting Principles from its inception in November 1989 through mid-1992; that is, AVBC had not reached its planned level of operations (the principal operations of the Company had either not commenced or not generated significant revenue), and was devoting most of its efforts to activities which included product research and development, establishing sources of supply, developing product markets and starting up production.

Deloitte's audit reports for the years ending December 31, 1990 and 1991 emphasized the uncertainties facing AVBC:

> The Company is in the development stage at December 31, . . . Recovery of the Company's assets is dependent upon future events, the outcome of which is indeterminable. In addition, successful completion of the Company's development program and its ultimate attainment of profitable operations is dependent upon obtaining adequate financing to fulfill its development activities and achieving a level of sales adequate to support the Company's cost structure.

By the end of 1992, although AVBC began to move beyond classification as a development stage enterprise, the Company continued to face vast financial uncertainties. Accordingly, the audit report and notes to the financial statements for the year ended December 31, 1992, emphasized Deloitte's conclusion that substantial doubt existed about AVBC's ability to continue as a going concern for a reasonable period. On this issue, the report stated:

> The accompanying financial statements . . . have been prepared assuming that the Company will continue as a going concern. . . . [T]he Company's recurring losses from operations, net stockholders' capital deficiency and negative operating cash flow raise substantial doubt about its ability to continue as a going concern.

Thus, not only did AVBC's financial statements disclose that the Company had no net earnings and no net worth, but,

in addition, Deloitte directly advised all readers of its report: (a) that future events, the outcome of which could not be predicted, would determine whether the Company would survive, and (b) that unless AVBC obtained adequate financing in the future and achieved a level of sales adequate to support its cost structure, it would not succeed.

Applying "an asset and income approach" to valuation, and relying on information contained in the financial statements at issue in the lawsuit[2], petitioner's valuation expert, Dennis R. Reinstein, concluded that AVBC and its common stock had *no* value. This confirms the conclusion of petitioner's damages expert, Dr. John Hekman, that the market value of AVBC stock was not based on current levels of Company assets, sales or earnings.

Also relying on financial statements audited by Deloitte, Wright, Houlihan and Associates, Inc. ("Wright, Houlihan"), an independent valuation company retained by the Company, concluded that as of October 1, 1992, AVBC and its stock had only negligible value. Wright, Houlihan wrote that "[b]ecause the Company has current operating losses and a history of losses, and negative net worth, public market multipliers based on earnings or book value are meaningless." Wright, Houlihan first determined that the gross market value of the Company was $2.8 million, and then derived a value for its stock, as of October 1, 1992, of $0.094 per share (applying a blockage discount to the large block of restricted stock being valued). Yet, in October 1992,

2. Specifically, the Deloitte-audited balance sheets of AVBC for the years ended 1992 and 1993; the Deloitte-audited AVBC statement of operations for the years ended 1991, 1992 and 1993; and the Deloitte-audited AVBC statements of cash flows for the years ended 1991, 1992 and 1993.

the quoted bid price for AVBC stock was approximately $2.50 per share. Thus, it is apparent that petitioner's expert, Dr. Hekman, was correct in concluding that "virtually all of the market value of AVBC stock during the Class Period was . . . *not* [due] to the current levels of sales, assets or earnings of the Company."

Petitioner purchased AVBC stock in September 1991, before any Deloitte-audited financial statement was issued. The complaint, brought against AVBC and certain of its former officers and directors, as well as Deloitte, alleges a number of claimed misrepresentations, including, particularly, publication by AVBC of allegedly false sales projections. As stated above, Deloitte played no role in the preparation or dissemination of those projections. Nevertheless, petitioner alleged that Deloitte violated Section 10(b) of the Securities and Exchange Act of 1934 (15 U.S.C. § 77j(b)) ("§ 10b") and Rule 10b-5 (17 C.F.R. § 240.10b-5) ("Rule 10b-5").

After reviewing the record presented to it, the district court ruled that the claims of the putative class who bought AVBC stock between August 1, 1991 and February 28, 1994 (the "Class Period") must be dismissed because the class could not satisfy all the elements under § 10(b) and Rule 10b-5. The district court determined that the class would have to satisfy the reliance element of its securities-fraud claim through a presumption, otherwise individual questions of reliance would predominate over questions common to the class. The district court ruled, however, that no presumption was available to the class. Because the action was not primarily an omissions case, involving the omission of material facts by the respondents, the class was not entitled to the *Affiliated Ute* presumption of reliance. The district

court also ruled that the class was not eligible for the fraud-on-the-market presumption because petitioner had not met his burden of establishing that the market for AVBC stock, which traded on the OTC market until December 1993, was efficient. The district court, therefore, decertified the class through December 1993.

The district court noted that the class might qualify for the fraud-on-the-market presumption during the period when AVBC stock traded over the BSE, from December, 1993 through February 28, 1994. The district court, however, decertified the class because petitioner could not establish that respondents issued any false statements or omissions during this period that caused any investor loss. After decertifying the class, the district court declined to exercise supplemental jurisdiction and, therefore, dismissed the state class claims. The district court then granted summary judgment on petitioner's individual federal and state claims in Deloitte's favor because his evidence was insufficient to implicate Deloitte's participation in any scheme to defraud him in connection with his purchase of AVBC securities. A majority of the Ninth Circuit panel hearing this case on appeal affirmed all of the district court's conclusions.

REASONS FOR DENYING THE WRIT

I. The Ninth Circuit Correctly Concluded That A Presumption Of Reliance Does Not Apply in This Case.

The Ninth Circuit affirmed the district court order granting summary judgment in Deloitte's favor and decertifying the plaintiff class because petitioner could not establish two essential elements of his case: reliance and

causation. To prevail on a securities fraud claim, petitioner was required to prove that: (1) Deloitte made misrepresentations or omissions; (2) the purported misrepresentations or omissions were material; (3) Deloitte acted with scienter; (4) petitioner relied on the purported misrepresentations or omissions; and (5) petitioner was damaged as a result of the purported misrepresentations or omissions. *Basic v. Levinson*, 485 U.S. 224 (1988). Specifically, with regard to the element of reliance, both the Ninth Circuit and the district court held that the putative plaintiff class was not entitled to invoke a presumption of reliance. Order and Opinion dated July 26, 1999 (App. A at 14a, 15a and 17a).

In the context of federal securities cases, this Court has allowed a presumption of reliance in two very limited circumstances, both of which present peculiarly difficult evidentiary burdens for a plaintiff seeking to establish reliance. In *Affiliated Ute,* a case that involved the failure to disclose material information during face to face meetings, this Court held that positive proof of reliance is not a prerequisite to recovery in cases involving "primarily a failure to disclose." 406 U.S. at 153. This Court adopted the presumption of reliance in cases involving primarily omissions because "[u]nlike instances of affirmative misrepresentation where it can be demonstrated that the injured party relied upon affirmative statements, in instances of total nondisclosure, as in *Affiliated Ute*, it is of course impossible to demonstrate reliance." *Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88, 93 (2d Cir. 1981); *see also Basic,* 485 U.S. at 245; *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976). Omission cases involve what has been characterized as "a speculative negative (I would not have bought had I known)." *Blackie, id.* A presumption of reliance is

unnecessary and inappropriate in misrepresentation cases because a plaintiff can identify the alleged misrepresentations and demonstrate how each misrepresentation induced him or her to act.[3]

In *Basic*, this Court adopted a presumption of reliance in the form of the fraud-on-the-market doctrine. That doctrine is "based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business." *Basic*, 485 U.S. at 241. This Court adopted the fraud-on-the-market doctrine because it provided an appropriate (but rebuttable) link between the dissemination of information into the market and a decision to purchase or sell based on market price. This Court made it clear, however, that the fraud-on-the-market doctrine applies *only* if the market for the particular security at issue is efficient — that is, so "open and developed" that the price of the security reflects all available public information about the economy, about financial markets, and about the specific company involved. *Basic*, 485 U.S. at 248, n.27. If the security at issue trades in an inefficient market, the presumption does not apply.

Contrary to petitioner's argument, in its Binder Decision, the Ninth Circuit did not issue any precedent-shattering pronouncements concerning either the *Affiliated Ute* presumption of reliance or the fraud-on-the-market doctrine. The Ninth Circuit simply examined all the uncontroverted evidence presented to it and then determined that neither the *Affiliated Ute* presumption nor the fraud-on-the-market doctrine applied in this case.

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3. This is the complete answer to the argument in Judge Reinhardt's dissent on which petitioner places so much reliance in his presentation to this Court. *See, e.g.* Petition at 18-20.

II. The Ninth Circuit Correctly Held That This Case Does Not Primarily Involve Omissions And, Therefore, the *Affiliated Ute* Presumption Does Not Apply

The Ninth Circuit concluded that the putative class was not entitled to invoke the presumption of reliance articulated in *Affiliated Ute* because this case does not primarily involve omissions. The substance of petitioner's claim against Deloitte is that the financial statements audited by Deloitte were allegedly false and misleading.[4] *See* First Amended Class Action Complaint filed December 10, 1996 (App. C at 43c, & 29(16); 50c, & 29(34); 53c, & 29(41)). In reaching the determination that petitioner's case did not primarily involve omissions, both the Ninth Circuit and the district court carefully analyzed the allegations of the complaint and reached the same conclusion: "Binder's complaint contains both allegations of omissions and misrepresentations, and at the very least, must be characterized, as the district court noted, as a 'mixed case of misstatements and omissions.' " Order and Opinion dated July 26, 1999 (App. A at 12a).

4. Indeed, the fact that petitioner's allegations against Deloitte relate to written financial statements is sufficient to dispose of his *Affiliated Ute* argument as to Deloitte because federal courts generally have held that cases involving "misstatement[s] and omission[s] within the four corners" of a financial or disclosure document do not implicate the *Affiliated Ute* presumption of reliance. *Vervaecke v. Chiles Heider & Co., Inc.*, 578 F.2d 713, 718 (8th Cir. 1978). *See also Huddleston v. Herman & MacLean*, 640 F.2d 534, 548 (1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375 (1983) ("[t]his case, involving alleged misstatements and omissions in a prospectus published pursuant to a public offering, cannot properly be characterized as an omissions case of the type for which the *Affiliated Ute* presumption was fashioned."). Significantly, the petition does not address this issue.

Consistent with Supreme Court precedent, a majority of the Ninth Circuit panel then concluded that in such a mixed case, petitioner could not invoke the *Affiliated Ute* presumption of reliance because the case could *not* be analytically characterized as one that primarily alleges omissions. Order and Opinion dated July 26, 1999 (App. A at 14a).

III. The Binder Decision Presents No Questions of National Importance That The Supreme Court Must Settle

The Ninth Circuit's conclusion that the *Affiliated Ute* presumption did not apply to the case before it is a well-reasoned decision that was directly based on Supreme Court precedent. Given that the Binder Decision does not conflict with any prior decisions of this Court, no questions of national importance are implicated. Simply put, the Binder Decision does not warrant an examination into federal substantive and procedural law by this Court, as petitioner claims. Petition at 16.

Not only does the Binder Decision not conflict with Supreme Court precedent, but it also does not conflict with the decisions of other Circuit Courts that have addressed the *Affiliated Ute* presumption of reliance. The fact that petitioner identifies absolutely no conflict among the Circuit Courts also supports the conclusion that this case does not warrant the intervention of the United States Supreme Court. In fact, petitioner ignores the degree of harmony that exists among the decisions of the Circuit Courts.

Affiliated Ute's holding that a presumption of reliance applies only in cases that involve primarily omissions has been consistently followed by all Circuit Courts. Only a few

Circuit Courts, moreover, have even addressed the issue of whether the *Affiliated Ute* presumption applies in so-called mixed cases. Of the Circuit Courts that have addressed this issue, all are in agreement with regard to the appropriate approach: a court must first analyze the facts of each particular case to determine if the case involves misrepresentations or omissions. Then, the court must determine if the *Affiliated Ute* presumption applies. *See Huddleston v. Herman & MacLean*, 640 F.2d at 548; *Finkel v. Docutel/Olivetti Corporation*, 817 F.2d 356, 359 (5th Cir. 1987), *cert. denied*, 485 U.S. 959 (1988); *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749, 756 (11th Cir. 1984); *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 188 (3rd Cir. 1981), *cert. denied*, 455 U.S. 938 (1982). The mere fact that each of these courts concluded that it had to determine first whether the case involved omissions *or* misrepresentations carries with it the understanding that under *Affiliated Ute*, omissions and misrepresentations are to be treated differently.

With regard to the conclusions reached by the Circuit Courts that have addressed the issue of whether the *Affiliated Ute* presumption applies in mixed cases, again, no conflict exists. In fact, all but one Circuit Court has expressly determined that the *Affiliated Ute* presumption does *not* apply in a mixed case.[5] For example, in *Huddleston v. Herman &*

5. *See Sharp v. Coopers & Lybrand, supra*. In *Sharp v. Coopers & Lybrand*, however, the Third Circuit recognized that the *Affiliated Ute* presumption generally applies to omissions. 649 F.2d at 187. Additionally, the Third Circuit declined to issue any sweeping pronouncement concerning the *Affiliated Ute* presumption and its application to mixed cases. 649 F.2d at 189, n.19. Rather, the Third Circuit held that in the particular circumstances of the case before it, which involved the appropriate jury instruction based on the (Cont'd)

MacLean, the leading "mixed case," the Fifth Circuit Court of Appeals held that "[A mixed] case is not a case in which the difficulties of proof of reliance require the application of the *Affiliated Ute* presumption." 640 F.2d at 548. The Eleventh Circuit in *Cavalier Carpets, Inc. v. Caylor* agreed with the *Huddleston* analysis and held: "We adhere to the mixed case rule of *Huddleston, supra*, and find that the jury was correctly instructed that it must find plaintiffs relied upon the misstatements and omissions for plaintiffs to recover." 746 F.2d at 757.

Another factor that undermines petitioner's argument of "material importance" is that *Huddleston*, which expressly addressed the issue of whether *Affiliated Ute* applies in mixed cases, has been considered by this Court. *Huddleston*, 640 F.2d at 548, *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375 (1983). This Court's affirmance of much of the Fifth Circuit's decision in *Huddleston* supports the conclusion that this Court intended the presumption created in *Affiliated Ute* to be available only in cases involving primarily a failure to disclose. *Huddleston*, 640 F.2d at 548. That conclusion is buttressed by this Court's denial of the petition for writ of certiorari in *Finkel v. Docutel/Olivetti Corp., supra*.

In *Finkel*, the Fifth Circuit discussed *Affiliated Ute* at considerable length and concluded that in light of this Court's decision in that case, a trial court must "analytically

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(Cont'd)
specific allegations against the defendants in that case, the district court correctly allocated the burden of proof on the issue of reliance. The Third Circuit most certainly did not hold that the *Affiliated Ute* presumption applies to all mixed cases, much less to cases like the one before this Court, which does not primarily involve omissions.

characterize a 10b-5 action as either primarily a nondisclosure case (which would make the presumption applicable), or a positive misrepresentation case." 817 F.2d 359. That, of course, is what the trial court did in this case, as the Ninth Circuit expressly observed. Order and Opinion dated July 26, 1999 (App. A at 13a-14a).[6] Just as there was no reason to grant certiorari in *Finkel* to review that analytic approach, none exists here.

IV. *Basic* Did Not Alter the *Affiliated Ute* Presumption

Petitioner argues that *Basic* altered the *Affiliated Ute* presumption by eliminating the requirement that a case must involve primarily omissions before the presumption of reliance may be invoked. Petition at 20. *Basic* did no such thing. *Basic* had nothing to do with the *Affiliated Ute* presumption of reliance, but, rather, whether this Court would recognize a presumption of reliance based on the fraud-on-the-market doctrine. In recognizing such a presumption, this Court cited *Affiliated Ute* merely to illustrate another circumstance in which the Court had permitted the invocation of a presumption of reliance. *Basic*, 485 U.S. at 243. Significantly, so as to leave no confusion about the point it was making concerning its earlier holding, in *Basic*, this Court immediately and explicitly cited to pages 153 and 154 of the *Affiliated Ute* decision. There, this Court stated

6. Stripped of all its claims of implicating questions of national importance, petitioner's argument boils down to the fact that he believes the Ninth Circuit erred in reaching its conclusion that the *Affiliated Ute* presumption did not apply in this case. That, however, is not a proper reason for seeking certiorari, as this Court has ruled that it will not grant certiorari simply to correct an error in a court of appeals decision. *Ticor Title Ins. Co. v. Brown*, 511 U.S. 117, 122 (1994). In any event, the Ninth Circuit's conclusion is amply supported by the record and contains no error.

unequivocally that "[u]nder the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery." *Affiliated Ute*, 406 U.S. at 153-154, directly cited by the Court in *Basic* at 485 U.S. at 243. Given the clear language in *Affiliated Ute* and the express citation to that language in *Basic*, petitioner cannot seriously claim that *Basic* altered the holding in *Affiliated Ute*.

Furthermore, contrary to petitioner's misreading of case law, *Affiliated Ute* was not a "mixed case." Petition at 17, fn. 3. In *Affiliated Ute*, this Court observed that the central feature of the defendants' fraud was to "stand mute" while facilitating the transfer of the plaintiffs' stock to third parties for less than full value. *Affiliated Ute*, 406 U.S. at 153. While the defendants did make some affirmative misstatements, those statements were few in number and clearly incidental to the underlying scheme to "stand mute." *Affiliated Ute*, 406 U.S. at 152, 153. This explains why this Court characterized the case as one involving "primarily a failure to disclose." *Affiliated Ute*, 406 U.S. at 153.

V. The Ninth Circuit Correctly Concluded That the Putative Class Could Not Invoke a Presumption of Reliance on the OTC Market for AVBC Stock

The Binder Decision also does not make precedent-shattering pronouncements concerning the fraud-on-the-market theory. The Binder Decision simply reflects the fact that petitioner was unable to meet his burden of presenting facts to establish that the OTC market for AVBC stock was efficient, a necessary precondition to invocation of the fraud-on-the-market presumption of reliance. As such, the Binder Decision does not conflict with *Basic*.

Petitioner offers the strained argument that the Binder Decision conflicts with *Basic* because it "develops" a test to determine the efficiency of a market, which *Basic* does not do. Petition at 26, fn. 10. Additionally, without citing any case law to support his point, petitioner argues that the test for determining whether the fraud-on-the-market doctrine applies is not whether the security at issue trades in an open and efficient matter, but if "information regarding the security and the issuer is available to participants in the trading market for such security." Petition at 25. The holding of *Basic* establishes that petitioner is wrong on both points.

The fraud-on-the-market doctrine was adopted because of the evidentiary problems that securities class action plaintiffs face in proving that when they purchased or sold a security they relied on a particular statement that affected the price of that security. In *Basic*, this Court, affirming a Sixth Circuit decision, held

> that in order to invoke the presumption of reliance [under the fraud-on-the-market doctrine], a plaintiff must allege and prove: (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) *that the shares were traded on an efficient market*; (4) that the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (5) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed.

Basic, 485 U.S. at 248, n.27 (emphasis added). This Court added that the second and fourth parts of the test could be collapsed into one. *Basic*, *id.* This Court said nothing about

eliminating the efficient market requirement. Therefore, petitioner is in error to the extent he suggests that the concept of an efficient market is not central to the *Basic* Court's analysis.

Additionally, the Binder Decision is not at odds with *Basic* because it "developed" a test to determine if a security traded in an efficient market. While it is true that this Court has not adopted a specific test to determine if the market for a particular stock is efficient, its decision in *Basic* provides more guidance than petitioner acknowledges. This Court spoke of an "open" market, a "developed" market, and a market in which the prices of the security reflect all available public information about the economy, about financial markets, and about the specific company involved. *Basic*, 485 U.S. at 248, n.27.

In determining whether the market for AVBC stock traded in an efficient market, which would trigger the fraud-on-the-market doctrine and its presumption of reliance, the Ninth Circuit applied the indicia of efficiency that were set forth in *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989). The *Cammer* decision simply analyzes and applies indicia of "open" and "developed" markets, and markets that reflect new information about a company in the price of that company's stock. As the Binder Decision correctly observed, the "*Cammer* factors are designed to help make the central determination of efficiency in a particular market." Order and Opinion dated July 26, 1999 (App. A at 16a-17a). They amplify *Basic*; they do not conflict with it. That is why so many other courts have applied the *Cammer* factors in their own analyses. *See* Order and Opinion dated July 26, 1999 (App. A at 15a-16a). The fact that the Ninth Circuit used the *Cammer* factors to analyze whether the market at issue was

efficient does not place the Binder Decision in conflict with *Basic*. The Ninth Circuit merely emphasized that for the *Basic* presumption to apply, a stock must be traded in an efficient market.

VI. Petitioner Failed to Establish a Genuine Issue of Fact with Respect to the Demonstrated Inefficiency of the OTC Market for AVBC Stock

The undisputed evidence established that AVBC stock was traded on the OTC market through "pink sheets" from at least the beginning of the putative class period (August 1, 1991) to December 1993. The "pink sheets" are daily listings of "bid" and "ask" quotes that do not necessarily reflect any actual trading and do not reflect the trading volume of any particular stock. The stocks quoted by dealers in the "pink sheets" (or, since approximately June 1990, on NASDAQ's computerized bulletin board) are on the lowest rung of the OTC market.

Whether or not the evidence in this case is examined under the *Cammer* test for efficiency, numerous key facts support the conclusion that the market for AVBC was not efficient. First, the trading volume of AVBC was not reported publicly. Therefore, for virtually the entire class period, important trading information for AVBC stock was not widely available, as required for a developed market. *See* 4 Bromberg & Lowenfels, *Securities Fraud and Commodities Fraud* at § 8.6 (1988).

Second, no evidence exists that suggests that any securities analysts followed AVBC or reported on the stock during the class period.

Third, while petitioner offered an expert who claimed through unsupported testimony that there were a "substantial number of market makers" during the would-be class period, he provided no competent evidence regarding such claimed market makers. In any event, "the mere number of market makers, without much more information, is . . . virtually meaningless." *O'Neil v. Appel*, 165 F.R.D. 479, 501-502 (W.D. Mich. 1996).

Fourth, AVBC has never been eligible to file an SEC Form S-3. The SEC allows companies to file the "abbreviated" S-3 form "only on the premise that the stock is already traded on an open and efficient market, such that further disclosure is unnecessary." *O'Neil*, 165 F.R.D. at 502. AVBC's ineligibility to file this form weighs strongly against the efficiency of the market for AVBC stock.

Instead of focusing on these facts, petitioner simply asserts that all securities trading on the OTC market "should be *deemed* to be trading in an 'efficient market.' " Petition at 27; emphasis added. In other words, petitioner seeks yet another presumption — indeed, an irrefutable presumption — regarding market efficiency, directly contrary to this Court's holding in *Basic* that "a plaintiff must allege *and prove* . . . that the shares were traded on an efficient market." 458 U.S. at 248, n. 27; emphasis added. Petitioner's argument also avoids the real issue, that is, whether the *market for AVBC stock* was efficient. With no evidence in the record to support any indicia of efficiency, as well as no competent or admissible expert testimony,[7] the Ninth Circuit correctly

7. The panel unanimously affirmed the district court's evidentiary rulings striking certain of the "expert" testimony that petitioner still seeks to urge on this Court. Order and Opinion dated (Cont'd)

concluded that petitioner did not meet his burden of establishing genuine issues of material fact as to whether the market for AVBC stock was efficient. Therefore, the putative class was not entitled to invoke a presumption of reliance on an efficient market.[8]

VII. The Record Established That Deloitte's Alleged Misrepresentations and Omissions Did Not Cause Petitioner's Loss

The Ninth Circuit properly held that petitioner failed to adduce evidence sufficient to raise a triable issue that any allegedly material misrepresentations made during the time that AVBC stock traded on the BSE caused any investor loss. Deloitte audited and reported on historical financial information. Petitioner's own expert asserted that the market value of AVBC's stock did not result from such reported historical financial information but, instead, from expectations of investors as to AVBC's future prospects.

(Cont'd)
July 26, 1999 (App. A at 22a-23a). By contrast, Deloitte offered competent evidence in the form of affidavits from its experts to show that there was no statistically significant movement of AVBC stock caused by news of corporate events or financial releases.

8. Petitioner tries to reargue the Circuit's affirmance of the district court's order decertifying the class after it concluded that no presumptions of reliance were available. Petition at 9-12. But, he does not argue that the district court abused its discretion in so ruling. Yet, that is the question on appeal. *See Six Mexican Workers v. Arizona Citrus Growers*, 904 F.2d 1301, 1304 (9th Cir. 1990). Instead, he asserts that the panel misread *Basic*. However, *Basic* plainly states that individual issues predominate when each putative class member must prove individual reliance. *Basic*, 485 U.S. at 242. Supreme Court review on this issue plainly is unwarranted.

Indeed, he determined that AVBC stock had a value of zero based on the very financial statements audited by Deloitte. Consequently, petitioner's expert concluded that "the current levels of sales, assets or earnings of the Company" were not causal factors inflating "the market value of AVBC's stock during the Class Period."

Given the uncontested fact that the historical financial statements Deloitte audited or allegedly commented on had no effect on the market value of AVBC stock, petitioner could not present a triable issue relating to his burden of proving that "the [alleged] misrepresentations and omissions . . . impacted the value of the investment." Entry of summary judgment for Deloitte, therefore, was warranted.

VIII. The Decision to Decertify the Class Does Not Conflict With Supreme Court Precedent

Petitioner argues that the Ninth Circuit decertified the class and dismissed the class Rule 10b-5 claims "solely on the basis that [petitioner] could not maintain individual claims against all of the same defendants because he could not satisfy the purchaser or seller requirement as to all of such defendants. . . ." Petition at 28. Petitioner's argument is wrong and misstates the holding of the Ninth Circuit.

The Ninth Circuit's decision to affirm the district court's dismissal of the class claims was not "solely on the basis that [petitioner] could not maintain individual claims." The Ninth Circuit affirmed the district court's decision to dismiss the claims of the putative class who bought AVBC stock during the Class Period because the class could not satisfy all the elements under § 10(b) and Rule 10b-5. As noted above, both the Ninth Circuit and the district court

determined that the class would have to satisfy the reliance element of its securities-fraud claim through a presumption, otherwise individual questions of reliance would predominate over questions common to the class. The Ninth Circuit, however, affirmed the district court decision that no presumption was available to the class because this action was not primarily an omissions case and petitioner had not met his burden of establishing that the market for AVBC stock was efficient. Order and Opinion dated July 26, 1999 (App. A at 14a and 17a). Given this, the Ninth Circuit affirmed the district court's decision to decertify the class through December, 1993. Order and Opinion dated July 26, 1999 (App. A at 17a).

The Ninth Circuit then affirmed the district court's decision to decertify the class from December, 1993 through February 28, 1994 (the end of the Class Period) because petitioner could not establish that Deloitte issued any false statements or omissions during this period that caused any investor loss. Order and Opinion dated July 26, 1999 (App. A at 19a). Only after going through this rigorous analysis did the Ninth Circuit affirm the district court's decision to grant summary judgment on petitioner's individual federal and state claims in Deloitte's favor because his evidence was insufficient to implicate Deloitte's participation in any scheme to defraud him in connection with his purchase of AVBC securities. Order and Opinion dated July 26, 1999 (App. A at 22a).

Petitioner also argues that the Ninth Circuit's decision to affirm the district court's decertification of the putative class conflicts with Supreme Court precedent that interprets and applies Rule 23 of the Federal Rules of Civil Procedure. Petition at 17. Specifically, petitioner claims that the Binder

Decision conflicts with *General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147 (1982), which purportedly stands for the proposition that a Rule 23 class representative need not possess the same claims against all the same defendants as all members of the proposed class so long as common issues of law and fact predominate. Petition at 27. Not only does the decision to decertify the class not conflict with *General Telephone*, but petitioner is also wrong in his analysis of *General Telephone*. In fact, *General Telephone* actually supports the district court's decision to decertify the class.

In *General Telephone*, this Court vacated a district court's decision, which had been affirmed by the circuit court, to certify a class because the plaintiff did establish the existence of common questions of law or fact that were common to claims of the plaintiff and the class. This Court ruled that the district court erred because it presumed the existence of common questions of law and fact and failed "to evaluate carefully the legitimacy of [the] named plaintiff's plea that he was a proper class representative." *Id.* The Court added that a proposed class representative must not only prove the validity of an individual claim, but must also establish the existence of common questions of law or fact. *General Telephone*, 457 U.S. at 158. The Court said nothing about a Rule 23 class representative not needing to possess the same claims against all the same defendants as other class members so long as common issues of law and fact predominate.

Here, the Ninth Circuit properly affirmed the district court's decision to decertify the class. As this Court instructed in *General Telephone*, the district court evaluated the legitimacy of petitioner's claim that he was a proper class

representative and refused to presume the requirements of Rule 23. The district court examined all the evidence and determined: (1) the class should be decertified for the period when AVBC stock was trading on the OTC market because petitioner could not establish the reliance element of his § 10b and Rule 10b-5 causes of action; and (2) the class should be decertified for the period when AVBC stock was trading on the BSE because petitioner could not identify any statements or omissions that could have caused any investor loss. Although the district court had previously certified the class, decertification was proper because even "after the class certification order is entered, the judge remains free to modify it in light of subsequent developments in the litigation." *General Telephone*, 457 U.S. at 160.

With regard to the district court's decision to decertify the class for the period when AVBC stock was trading on the BSE, the district court determined that petitioner could not even establish the validity of his individual claim, as is required under *General Telephone*. Given this, it would have been improper for the district court to "presume that [petitioner's] claim was typical of other claims." *General Telephone*, 457 U.S. at 158-159. Both the Ninth Circuit and the district court correctly determined that simply alleging violations of Rule 10b-5 does not mean that petitioner is an appropriate class representative. *See General Telephone*, 457 U.S. at 157 (quoting *East Texas Motor Freight System, Inc. v. Rodriguez*, 431 U.S. 395, 405-406 (1977) ("the 'mere fact that a complaint alleges racial or ethnic discrimination does not in itself ensure that the party who has brought the lawsuit will be an adequate representative' ").

CONCLUSION

For the reasons set forth above, the Court should deny the Petition for Writ of Certiorari.

Respectfully submitted,

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Supreme Court, U.S.
FILED
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No. 99-742

In The

Supreme Court of the United States

ALBERT AND ESTELLE BINDER,
in their individual capacities and on behalf
of all persons similarly situated,

Petitioners,

vs.

IAN R. WILSON, CARY S. FITCHEY,
MARK L. STEVENS AND DELOITE & TOUCHE,

Respondents.

On Petition For Writ Of Certiorari
To The Ninth Circuit Court Of Appeals

BRIEF IN OPPOSITION

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RESTATEMENT OF QUESTION PRESENTED

Properly construed, Mr. Binder's petition actually presents a narrow and straightforward inquiry:

> Whether the district court's factually-dependent and conventional application of *Basic*, *Affiliated Ute*, and Federal Rule of Civil Procedure 23, as affirmed by the Court of Appeals for the Ninth Circuit, warrants further review by this Court.

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STATEMENT OF THE CASE

A. Nature of the Case

This action presented the efforts of a relatively minor investor, Albert Binder,[1] who sought to rectify alleged investment losses he sustained after investing in a small "start-up" corporation, Aqua Vie Beverage Corporation ("AVBC"). Mr. Binder alleged his adequacy to be class representative and thus also brought this action for those similarly situated.

Mr. Binder's assertions predominantly focused on theories of recovery conventionally utilized in securities actions: Section 10(b) of the 1934 Act, including Rule 10b-5; aiding and abetting;[2] and a plethora of theories predicated upon state-law.[3]

Mr. Binder targeted AVBC itself;[4] its promoters and inside management: Thomas and Marie Gillespie, and

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[1] Mr. Binder prosecuted this action together with his spouse, Estelle. Mrs. Binder died during the pendency of this litigation and Mr. Binder evidently succeeded to her interest in the action.

[2] This allegation was voluntarily dismissed following the issuance of *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 114 S.Ct. 1439 (1994).

[3] Aside from Delaware law – applicable only to the alleged Breach of Fiduciary Duty count – the parties eventually concurred, and the district court agreed, that Idaho substantive law would apply to the claims predicated upon state law. (E.R., Vol. 9, Exhibit 53.1.) "E.R." identifies portions of the Petitioner's own excerpts of record (Circuit Rule 17-1.1) previously submitted to the Ninth Circuit.

[4] Curiously, Mr. Binder's counsel also vigorously prosecuted a *derivative* action, an action ostensively to *benefit* AVBC, against certain AVBC management in another action, the

Diane Karban; as well as its outside auditor, Deloitte & Touche. Binder also sought to affix liability to a number of "late comers" to the AVBC project, including outside director, Mr. Ian Wilson, part-time independent consultant, Mr. Cary Fitchey, and outside director (and AVBC President for a few months in 1994), Mr. Mark Stevens.

Binder's allegations largely consist of prolix and run-on sentences which basically attempted to establish Section 10(b) liability. These assertions presented both material misstatements as well as omissions as the purported basis for the claim. (Appendix C, First Amended Class Action Complaint.)

B. Course of Proceedings

Mr. Binder, a resident of the East Coast, commenced this action on March 4, 1994, in the District Court for the Central District of California. As the matter progressed, an involuntary petition for bankruptcy was filed against AVBC in early 1995.[5]

This action was eventually transferred to the District Court for the District of Idaho where it was assigned to Chief Magistrate Williams. Once "back on track," the court heard previously filed Rule 12(b) motions and

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Fite, et al. v. AVBC case. That action as directed against Mr. Wilson was dismissed. The nature of the dismissal was not readily apparent, but Binder did not dispute this circumstance.

[5] Mr. Binder's counsel actively participated in that AVBC bankruptcy on behalf of the plaintiffs who previously prosecuted the *Fite* derivative action. Following a perceived adverse ruling there, Binder tardily appealed to the district court, an appeal which was subsequently dismissed.

issued rulings accordingly which, *inter alia*, dismissed Mr. Binder's personal claim as directed against Messrs. Wilson and Fitchey. (Memorandum Opinion and Order, dated March 31, 1996, No. 64.) A class was conditionally certified. (Order of Court, August 8, 1996, E.R., Vol. 7.) Discovery ensued.

Eventually, the court conducted a hearing on subsequently filed Rule 56 motions asserted by some – but not all – defendants. The court ruled. That ruling was clarified by Order dated February 14, 1997. (Appendix B.) Judgments of Dismissal were then entered as to some – but not all – defendants. Those judgments were certified in accordance with Rule 54(b) on July 3, 1997. Mr. Binder appealed. Mr. Binder's non-appealed remaining claims primarily focused upon AVBC's promoters and its inside management and financial staff (the Gillespies, Karban, and Good); those claims are being held in abeyance. (Order, dated July 3, 1997, E.R. Vol. 9, Exhibit 53.B.) (Appendix 1.)

C. Operative Facts

1. Preliminary Factual Considerations

Though Binder has inundated his petition with various factual "rabbit trails," the facts truly necessary for resolving this petition are minimal. Of foundational import here is chronology: one will not understand ***why*** something happened until one understands ***when*** it happened. Here, Binder broadly references a number of assertions with little, if any, chronological foundation. He rarely coordinates these "facts" with the arrival and

departure of the targeted defendants or their actual conduct. One is left with the impression – from Binder – that *all* defendants *equally* participated in *each* alleged transgression. Just the opposite is true.

To illustrate, Binder intensely focuses on events occurring during 1990, 1991, and early 1992. Tales are told about acquiring public shells, broken promises, the failure to issue shares, the failure to report liabilities, wild-eyed press releases, defective product, etc. (*See, e.g.*, Petition, pp. 4-8.) What is missing from this litany of infamy is a careful enunciation concerning the Wilson defendants (Messrs. Wilson and Fitchey) – none of whom were at all involved with AVBC until the latter portion of 1992 at the earliest. Nothing Mr. Binder supposedly relied upon in procuring AVBC stock can be connected with the Wilson defendants, which is why Mr. Binder's individual Rule 10b-5 claim was dismissed early in this lawsuit. (Memorandum Opinion and Order, dated March 31, 1996, No. 64.) In truth, the serious transgressions he identifies were those committed, if at all, by those AVBC insiders remaining in the lawsuit who were present in 1990 and 1991: Gillespie and Karban. With this chronological note in mind, the following discussion will identify the facts pertinent to Messrs. Wilson and Fitchey. These facts underscore the correctness of the district court's Rule 56 determinations and thus illustrate the utter conventionality of the issues at hand.

2. General Corporate Overview

Plaintiffs Albert and Estelle Binder brought this class action suit in their individual capacity and on behalf of a

class of investors who purchased the AVBC stock between August 1, 1991, and February 28, 1994. AVBC is a Delaware corporation with its principal place of business in Idaho.

AVBC, founded in 1991, developed, manufactured, and distributed non-carbonated, flavored spring water beverages designed to appeal to both bottled water drinkers and "new age" beverage customers.[6] Since the commencement of this litigation, an involuntary petition for relief under Chapter 11 of the Bankruptcy Code was filed against AVBC. Prior to this development, AVBC's common stock was reported only in the over-the-counter ("OTC") market "pink sheets" until December 1993, at which time trading of AVBC's common stock commenced on the regional Boston Stock Exchange ("BSE"). AVBC's common stock does not trade, and has never traded, on a national exchange. As a result, an average weekly trading volume, which would have described the nature of AVBC's trading, never existed nor was established. There was never a significant number of securities analysts that followed and reported on AVBC's stock during the class period.

Named plaintiff Albert Binder is a former shareholder of AVBC who allegedly purchased 3000 shares of AVBC's common stock in September 1991 for approximately $4 a share, and sold the stock in December 1993 for approximately $1 a share. No part of this transaction was in any way connected with the Wilson defendants.

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[6] The "new age" beverage category includes beverages with lower calories, less caffeine, less alcohol, and fewer artificial ingredients.

3. The Wilson Defendants: Factual Specifics

a. As to Ian R. Wilson

Ian R. Wilson first heard of AVBC in 1992. (Deposition of Ian R. Wilson ("Wilson Depo."), p. 7, Ll. 19-23, E.R., Vol. 2, Exhibit 18.A.) Wilson met Mr. Gillespie for the first time in 1992. (Wilson Depo., p. 18, L. 2 – p. 20, L. 10, E.R., Vol. 2, Exhibit 18.A.) At that meeting, Wilson was very impressed with the concept of AVBC's spring water product and thought that the proposed names of some of the products were "very innovative and very appealing." (Wilson Depo., p. 20, L. 13 – p. 21, L. 25, E.R., Vol. 2, Exhibit 18.A.) Wilson joined the AVBC board in late 1992. (Wilson Depo., p. 17, L. 24 – p. 18, L. 1, E.R., Vol. 2, Exhibit 18.A.)

Wilson's position on the board was that of an outside director. (Wilson Depo., Exhibit 352, E.R., Vol. 2, Exhibit 18.E.) Wilson was listed as "additional director" separately from full time employees. (Wilson Depo., p. 204, Ll. 10-14; p. 256, Ll. 16-18, E.R., Vol. 2, Exhibit 18.A; Wilson Depo., Exhibit 349, E.R., Vol. 2, Exhibit 18.D "Statement for NASDAQ hearing committee" ("I am one of two outside directors of Aqua Vie Beverage Corporation and have been a director since October 1992.").) As an outside director, Wilson, a San Francisco resident, did not have access to information about AVBC's day-to-day operations. (Wilson Depo., p. 204, Ll. 3-14, E.R., Vol. 2, Exhibit 18.A.) Wilson's role as an outside director excluded any involvement with the "*Fite* litigation" or AVBC's NASDAQ application, and Wilson specifically asked that he not be involved in those areas. (Wilson Depo., p. 214, Ll. 17-24, E.R., Vol. 2, Exhibit 18.A.)

Regarding AVBC's dealings with its distributors (such as Golden Brands), Wilson testified, "I was a director to the company, not an active executive. I didn't get involved in things like that. And I don't know." (Wilson Depo., p. 304, Ll. 7-15, E.R., Vol. 2, Exhibit 18.B.) Wilson's role as a director was only to "look at the product development and the strategy." (Wilson Depo., p. 366, Ll. 9-13, E.R., Vol. 2, Exhibit 18.B.) Wilson testified that he had no knowledge of what AVBC was telling its distributors or other purchasers regarding the product's anticipated shelf life, noting that "There's simply no way a director gets involved in that level of activity." (Wilson Depo., p. 164, Ll. 8-12, E.R., Vol. 2, Exhibit 18.A.) Wilson also testified that "It is not the role of the director to interfere with operations." (Wilson Depo., p. 141, Ll. 21-22, E.R., Vol. 2, Exhibit 18.A.)[7]

Wilson did not involve himself in any matters that might have predated his October 1992 arrival on the board. (Wilson Depo., p. 218, Ll. 18-22, E.R., Vol. 2, Exhibit 18.A.) Wilson had not yet become involved with AVBC at the time AVBC first started producing its lightly flavored spring water product. (Wilson Depo., p. 311, Ll. 13-19, E.R., Vol. 2, Exhibit 18.B.) The production run that allegedly resulted in tinted product occurred prior to Wilson's involvement with AVBC. (Wilson Depo., p. 317, L. 17 - p. 318, L. 8, E.R., Vol. 2, Exhibit 18.B.) Wilson also

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[7] Mr. Wilson has held numerous directorships, including positions with Novell and Revlon. (*See* Wilson Depo., p. 213, Ll. 17-18, E.R., Vol. 2, Exhibit 18.W; Exhibit W to Affidavit of Counsel for Press Release of September 30, 1992, "Ian R. Wilson Joins Aqua Vie Beverage Corporation's Board of Directors.")

had no association with AVBC during the time the "Lopez transaction" transpired in 1991. (Wilson Depo., p. 371, Ll. 2-9, E.R., Vol. 2, Exhibit 18.B.)

During his involvement with AVBC, Wilson never saw a business plan or press release that he believed AVBC was distributing to prospective investors containing sales projections that he felt were overly optimistic. (Wilson Depo., p. 205, L. 25 – p. 208, L. 3, E.R., Vol. 2, Exhibit 18.A.) Wilson testified that he never had any reason to disbelieve Gillespie's representations in the press releases he saw. (Wilson Depo., p. 207, L. 20 – p. 208, L. 19, E.R., Vol. 2, Exhibit 18.A.) Wilson believed that Gillespie's sales projections for the second year of AVBC's operations were reasonable. Regarding this belief, Wilson was asked during his deposition whether he had any knowledge of any other beverage company that had introduced noncarbonated flavored water products that achieved sales of $100 million in the first five years of operation. Wilson answered in the affirmative and identified concrete examples of other beverage companies, including a company with sales of over a billion dollars within the first five years. (Wilson Depo., p. 257, L. 22 – p. 259, L. 25, E.R., Vol. 2, Exhibit 18.A.) Wilson had no knowledge of or involvement with AVBC accounting practices including the "booking" of sales of AVBC product in the first quarter of 1993. (Wilson Depo., p. 278, Ll. 2-8, E.R., Vol. 2, Exhibit 18.A.)

Wilson was never interested in buying and selling AVBC stock and he only purchased stock in order to become an AVBC board member. (Wilson Depo., p. 269, Ll. 3-6, E.R., Vol. 2, Exhibit 18.A.) Wilson never sold any shares of AVBC stock. (Wilson Depo., p. 233, Ll. 7-9, E.R.,

Vol. 2, Exhibit 18.A.) Wilson never exercised any options to purchase AVBC stock. (Wilson Depo., p. 233, Ll. 18-23, E.R., Vol. 2, Exhibit 18.A.) Wilson has never been paid any money by AVBC for the director services he provided. (Wilson Depo., p. 234, Ll. 2-5, E.R., Vol. 2, Exhibit 18.A.) Wilson never received any economic benefit from his relationship with AVBC except for some free (i.e., sample) water product. (Wilson Depo., p. 234, Ll. 8-18, E.R., Vol. 2, Exhibit 18.A.)

Wilson and Gillespie had a "falling out" around August 1994. (Wilson Depo., p. 185, L. 13 – p. 187, L. 13, E.R., Vol. 2, Exhibit 18.A.) This resulted from an accumulation of problems caused by Gillespie, including Gillespie's failure to satisfy certain obligations and Gillespie's actions regarding a $100,000 insurance company refund to AVBC. (Wilson Depo., p. 184, L. 14 – p. 186, L. 19, E.R., Vol. 2, Exhibit 18.A.) Wilson's directorship at AVBC was concluded when he allowed his directorship to expire during the 1993-1994 year. (Wilson Depo., p. 95, Ll. 4-13, E.R., Vol. 2, Exhibit 18.A.)

b. As to Cary S. Fitchey

Cary Fitchey "joined" AVBC in June 1992 as a Consultant. (Wilson Depo. Exhibit 347, E.R., Vol. 2, Exhibit 18.C (form 10k).) Gillespie retained Fitchey as a consultant. (Wilson Depo., p. 198, Ll. 8-10, E.R., Vol. 2, Exhibit 18.A.) Wilson testified that "Cary Fitchey is a consultant. He's not an operating man." (Wilson Depo., p. 201, Ll. 24-25, E.R., Vol. 2, Exhibit 18.A.) From Wilson's perspective, Fitchey was never on the AVBC board. (Wilson Depo., p. 171, Ll. 11-24, E.R., Vol. 2, Exhibit 18.A.)

The only contact that Cary Fitchey had with AVBC was as an outside consultant from the summer of 1992 through the summer of 1993. (Fitchey Depo., p. 14, L. 14 – p. 15, L. 6; p. 54, L. 17 – p. 56, L. 7, E.R., Vol. 2, Exhibit 18.Y.) Fitchey was never an officer, executive officer, or employee of AVBC. (Fitchey Depo., p. 270, Ll. 1-11, E.R., Vol. 2, Exhibit 18.Y.) He was never a member of the board of directors. (Fitchey Depo., p. 14, Ll. 20-21, E.R., Vol. 2, Exhibit 18.Y.) He never introduced himself or acted as the president of the company. (Fitchey Depo., p. 270, Ll. 12-17, E.R., Vol. 2, Exhibit 18.Y.) Also, Fitchey was never part of the management team of AVBC. (Fitchey Depo., p. 270, Ll. 18-20, E.R., Vol. 2, Exhibit 18.Y.) He was never involved in AVBC staff meetings. (Fitchey Depo., p. 335, L. 25 – p. 336, L. 1, E.R., Vol. 2, Exhibit 18.Y.) He did not have an assigned office or an assigned secretary in Ketchum, Idaho, the AVBC corporate offices. (Fitchey Depo., p. 58, L. 8 – p. 59, L. 21, E.R., Vol. 2, Exhibit 18.Y.)

Additionally, Fitchey had little, if any, involvement with the type of documentation relied upon by Binder. For example, Fitchey was not involved in preparing financial statements (Fitchey Depo., p. 80, Ll. 21-24; p. 267, L. 22 – p. 268, L. 24, E.R., Vol. 2, Exhibit 18.Y), press releases (Fitchey Depo., p. 66, L. 18; p. 66, L. 25 – p. 67, L. 10, E.R., Vol. 2, Exhibit 18.Y; p. 85, L. 5 – p. 86, L. 7; p. 279, L. 9 – p. 280, L. 24, E.R., Vol. 2, Exhibit 18.Y), or forecasts (Fitchey Depo., p. 271, Ll. 13-16; p. 273, Ll. 5-14, E.R., Vol. 2, Exhibit 18.Y).

The foregoing factual considerations underscore the factual propriety of the district court's ruling in this conventional legal setting.

ARGUMENT AND REASONS FOR DENYING THE PETITION

The Petition at best simply pays lip service to Rule 10's guideposts concerning certiorari. Mr. Binder, by bare conclusion, merely asserts that the district court's rulings somehow grossly deviated from accepted practice and thereby conflict with this Court's decisions in *Basic* and *Affiliated Ute*.[8] The Petitioner labors intensely to create the aura that this matter is one of national import, when in reality, it only represents an invitation for this Court to review conventional and discretion-laden determinations.

This Petition presents no more than the efforts of a disgruntled, but persistent, litigant who continues to quarrel with lower court rulings. Those rulings did not create "new law," but rather, conventionally applied existing law, and did so consistently with Rule 56. It is the Petitioner's own Rule 56 evidentiary failings together with the lower tribunals' application of well-settled law which engender the Petitioner's dissatisfaction. The correctness of these conclusions will be verified in the discussion which follows.

At the outset, it should be reiterated that both the Majority and the dissenting judge concurred as to several key points. First, they each agreed that because Mr. Binder lacked a claim against Wilson, summary judgment was properly granted in this regard. Second, they each affirmed the district court's evidentiary rulings – rulings which evaluated whether Mr. Binder, individually and as

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[8] Interestingly, the Petition is devoid of even an assertion – let alone a demonstration – that the Ninth Circuit's rulings engender a clash with the decisions of other Courts of Appeal.

a class representative, had discharged his various Section 10(b) burdens under Federal Rule of Civil Procedure 56 and *Celotex v. Catrett*, 477 U.S. 317 (1986). He did not, and no member of the panel disputed this point.

Consequently, as to this case, it is apparent that no basis exists for yet again reassessing the Rule 56 analysis already reviewed and affirmed by the Majority. The question thus presented concerns whether the Majority has somehow deviated from extant or controlling precedent.[9] Despite the noisy rhetoric of the Petitioner, the Majority apprehended the proper issue and applied the operative law to that issue – and did so well within the parameters of established precedent. This conclusion is confirmed by a number of considerations, including the fact that the dissent – invoked by the Petitioner – argued for a new rule to be embraced. Axiomatically then, the Majority, if it comported with extant precedent and thereby resisted creating a new expanded theory of liability, as urged by the dissent, did not commit error. Review, under such circumstances, is unwarranted.[10]

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[9] Notably, the Petitioner has not identified any conflict – real or apparent – among the Circuit Courts engendered by the Majority's incisive, yet conventional reasoning and opinion.

[10] Respondents Wilson and Fitchey, rather than wearying the Court's eyes by reiterating Respondent Deloitte's argument which similarly opposes granting the Petition, will instead simply by this reference, acknowledge, adopt, and incorporate Deloitte's substantive points.

I.

A PROPER READING OF *AFFILIATED UTE* VERIFIES THE CORRECTNESS OF THE MAJORITY'S REASONING AND CONCLUSIONS

Distilled to its essence, Binder seeks the wholesale jettisoning of all evidentiary hurdles facing a claimant who has alleged fraud in connection with a purchase or sale of securities. He contends that in reality, though apparently unrecognized for years, *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), essentially dispensed with a claimant's proof concerning reliance by creating a sweeping presumption of reliance – available irrespective of the nature of the fraud claim. Petitioner errs.

First, Mr. Binder's position is counter-intuitive. If, as he contends, *Affiliated Ute* provided a presumption for every case alleging securities fraud, then the Court's subsequent decision in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), is essentially surplusage. If "logic" requires negating the distinction between "omission cases" and "misrepresentation cases," then this Court behaved "illogically" because *Basic* refused to apply *Affiliated Ute* as broadly or as categorically as Binder now urges. Moreover, this Court did not view *Affiliated Ute* as squarely answering the question posed in *Basic*. Therefore, the supposed breadth of *Affiliated Ute* disappears when viewed through later precedent. Simply put, if Binder's thesis is correct, then *Basic* missed the analytic boat altogether.

Second and more critically, Mr. Binder fails to address the factual context underlying both *Affiliated Ute* and *Basic*. Understanding the unique factual contexts of

both decisions provides guidance for understanding the legal rationales of those decisions. These factual distinctives help explain the Court's recognition and tailoring of presumptions applicable in certain – but not all – situations. The Petitioner fails to consider these crucial factual distinctives and thereby misconstrues the utility and function of these presumptions.

In *Affiliated Ute*, the transaction was a personal, non-public matter essentially *involving a fiduciary*. *Affiliated Ute*, 406 U.S. at 153-54. The seller in that case functioned as a fiduciary and therefore in the nature of the case, possessed a duty to speak. From the purchaser's perspective, his seller was inherently an "object of trust," a fiduciary. It was on this basis that the Court, understanding that the allegations there primarily concerned material omissions, recognized a presumption of reliance.

Purchasers reasonably rely on fiduciaries to disclose material information. When a fiduciary is silent, the purchaser can rightly rely on that silence. This is because the silent party, since he is a fiduciary, *already owed* the purchaser material disclosure. A purchaser is, by definition, entitled to rely on his fiduciary throughout the transaction.

In *Basic* however, there was no involvement by a personal fiduciary, that is, one who by definition is charged with an obligation to speak. Rather, in *Basic*, the transaction was a public purchase which occurred in a public market. Absent a fiduciary's involvement as in *Affiliated Ute*, there was no obvious "object of trust."

In response to this circumstance, the Court did not, as Mr. Binder urges, simply expand *Affiliated Ute* to supply a presumption. Rather, the Court first needed to determine to what extent a purchaser may reasonably rely on a non-fiduciary. The question presented was thus whether an impersonal market could be a proper "object of trust." In answering this question, *Basic* determined that an impersonal market could be an "object of trust," but only:

> [B]ased on the hypothesis that, in an ***open*** and ***developed securities market***, the price of a company's stock is determined by the available material information regarding the company and its business.

Basic, 485 U.S. at 241 (emphasis added). Just any market could not properly be considered an "object of trust" like the fiduciary in *Affiliated Ute*. Consequently, *Basic* established some "sideboards" for determining just how a public securities market could be an object of trust – analogous to a fiduciary – which reasonably could permit a presumption of reliance. Stated differently, a market is not, by definition, trustworthy, and accordingly, *Basic* explored just when a market could be deemed sufficiently trustworthy in order to permit a presumption of reliance.

In contrast, *Affiliated Ute*'s transaction involved a fiduciary, which by definition is an object of trust. And, because a fiduciary possesses a duty to speak, *Affiliated Ute* recognized a presumption in that context, especially where the gravamen involved "primarily a failure to disclose." *Affiliated Ute*, 406 U.S. at 153. *Basic* addressed a different question.

Accordingly, because *Affiliated Ute* and *Basic* addressed two different questions, the fact that they presented two different, though related, answers to those questions should be recognized. *Affiliated Ute* does not apply here therefore for two primary reasons: (1) this case does not involve a personal transaction involving a fiduciary; and (2) this case does not primarily involve material omissions.

Accordingly therefore, Mr. Binder, by failing to appreciate the actual issues facing the Court in these two decisions, has blurred the important analytical distinctiveness of each decision. He, by misconstruing both decisions, has attempted to artificially create a conflict, when in reality, none exists. Both the district court and the Majority presented a more informed analysis, an analysis consistent with both *Affiliated Ute* and *Basic*, as well as their progeny. Accordingly therefore, because the Majority simply applied the operative rule to the facts of this specific case, no basis exists for granting the Petition.

II.

THE CLASS'S EXTANT EVIDENTIAL FAILURES UNDER RULE 56 AND *CELOTEX* RENDERED *BASIC*'S FRAUD ON THE MARKET PRESUMPTION INAPPLICABLE TO THIS ACTION

Mr. Binder's next contention centers on the Majority's assessment of *Basic*'s fraud on the market presumption as applied to this case. In particular, Mr. Binder contends that both the district court and the Majority improperly narrowed *Basic*'s applicability by investigating whether the AVBC stock at issue traded upon an

efficient market. This contention distorts *Basic*'s teaching in several respects. In reality, it is Mr. Binder who has advanced a thesis which contradicts *Basic*. This is true for several reasons.

First, Mr. Binder contends that the Majority has contradicted *Basic* because it affirmed the district court's consideration of various factors in determining whether the fraud on the market presumption was available *vis-a-vis* AVBC stock. This assertion is fallacious since it attempts to create error by equating *precision* with *contradiction*.

Basic, in articulating the predicate for applying the fraud on the market presumption, noted that the presumption is available in an open and developed market. *Basic*, 485 U.S. at 241, 242. Later cases, in following *Basic* and interpreting this point, developed criteria for actually applying this presumption. This later development, as expressed, for example, in *Cammer v. Bloom*, 711 F.Supp. 1264 (D.N.J. 1989) simply reflects *greater precision* in relation to applying the *Basic* standard – not a *contradiction* of it.

To illustrate: To say that *"the **black** cat is on the **round** table"* is not to contradict the statement that *"the cat is on the table."* Mr. Binder has claimed error by confusing increased *precision* with *contradiction*. In the same way, the decisions following *Basic*, such as *Cammer*, which grapple with applying Basic's "open and developed" market standard are simply explicating this standard; they are not contradicting or abrogating it. An open and developed market will usually reflect – at least to some degree – the criteria recognized by *Cammer*. Just as later decisions

developed Fifth Amendment protections following *Miranda*'s lead, later courts, including the Majority, did the same thing *vis-a-vis Basic*. This sort of legal analysis and methodology reflects fundamental jurisprudence – not error of great national import.

Second, Mr. Binder continues to misapply the plain teaching of *Basic* in urging that the Petition be granted. *Basic*, in explaining the fraud on the market presumption, stated that the presumption is available because:

> [a]n investor who buys or sells stock ***at the price set by the market*** does so in reliance on the integrity of that ***price***.

Basic, 485 U.S. at 247 (emphasis added). Consequently, the market that sets the price must be deemed "efficient." *Basic*, 485 U.S. at 248 n.27. Note carefully: the proper inquiry focuses on the ***price*** of the ***particular stock*** in question – ***not*** simply the ***market*** which offers the stock for sale or purchase.

Plainly then, the district court and the Majority were precisely following *Basic* when they evaluated whether, under Rule 56 and *Celotex*, Mr. Binder had proffered sufficient evidence which depicted a genuine issue of material fact ***as to the price set by the market for AVBC stock***. He did not.

Undisputedly, the AVBC stock traded on the "over the counter" ("OTC") pink sheets, mere compilations which did not establish any price for a given stock. Rather, the pink sheets at issue here simply reported "bid" and "ask" prices; the actual ***price*** of the AVBC stock was never actually ***set by*** this market as required by *Basic*. Thus, under *Basic*, there could be no "open" and

"developed" market as to AVBC stock – on this factual record – because the market did not set the stock price.[11]

Put differently, Mr. Binder has wrongly asserted that it is the ***exchange*** on which the stock sells – as opposed to the ***price-setting market*** of the ***actual stock*** in question – which gives rise to the presumption.[12] Here, the district court and the Majority did precisely what *Basic* required: evaluate whether, in this particular case as to the price of this particular stock, the market was, to use *Basic*'s shorthand, "efficient." Given the decided absence of genuinely

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[11] Mr. Binder badly mischaracterizes the Majority when he implies that the Majority has determined that under no circumstance could the OTC market be deemed efficient. In reality, the Majority, in attempting to contextualize its discussion, noted that some federal courts have in fact held that the OTC market is incapable of being efficient. *Binder*, slip op. at 3 and 4. The Majority, however, did not so hold, and, in fact, conducted an assessment consistent with *Basic* in this regard and predicated upon the extant factual record.

[12] Indeed, Binder actually argues for a formalistic bright line test which would declare that a purchaser of any stock traded by any SEC reporting company may by definition avail himself to the fraud on the market presumption. This invitation travels wells beyond *Basic* which requires that the market – in the particular stock at issue – be open and developed, i.e., one that actually sets the securities' price. These condition precedents did not exist here, and Binder adduced no competent evidence (*see* Rule 56(e)) engendering a genuine triable issue as to them. Summary judgment was manifestly proper given this material evidentiary defect, a defect which even the dissent acknowledged.

controverted factual issues present in the record, summary judgment was properly granted to Deloitte, and Messrs. Wilson and Fitchey.[13]

III.

PETITIONER'S MISCELLANEOUS POINTS INVOKED AS GROUNDS FOR ACCEPTING THE PETITION PRESENT NOTHING MORE THAN A QUARREL WITH THE LOWER COURTS' DISCRETION-LADEN DETERMINATIONS

A. As to Class De-Certification

The Petitioner asserts – like a Y2K doomsayer – that the district court's rulings signal the death knell to all class actions involving market-related securities transactions. This is unpersuasive for several reasons. First, this assertion misconstrues the district court's actual rulings. The district court announced no sweeping rule that categorically – in advance of actual considerations – bars class certification in these types of cases. Instead, the court simply determined that ***in this case*** based upon the ***extant record,*** this particular putative class could not satisfy the reliance requirement in this particular Rule 10b-5 setting, and thus, reliance would need to be individually proved. Based upon a mix of considerations, the

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[13] Recall that both the Majority and the dissent affirmed the district court's evidential determinations in this regard. *Cf., Goldkrantz v. Griffin, et al.*, 1999 U.S. Dist. LEXIS 4445, Fed.Sec.L.Rep. (CCH), ¶ 90,462 (Defendants' expert witness established that drop in stock's price unrelated to Defendants' alleged conduct).

court determined, in its discretion, that de-certification would be appropriate.

Second, and confirming this first point, is the fact that the Court of Appeals' decision has not been embraced as a panacea for defendants named in securities litigations. Indeed, *Binder* has only been minimally cited, and in those cases, none of the supposed earth-shattering repercussions – forecasted by Mr. Binder – were touted or even commented upon.

B. As to Supplemental Jurisdiction

The Petition similarly identifies, as a basis for granting the Petition, the district court's discretionary ruling refusing to exercise supplemental jurisdiction over certain state law claims. The district court, however, in viewing the totality of the record, declined supplemental jurisdiction in accordance with 28 U.S.C. Section 1367(c). Again, this point simply presents the Petitioner's quarrel with a routine discretionary ruling, a ruling utterly devoid of national import, which in no way supports the granting of the Petition.

C. As to Rule 56(e) Evidentiary Rulings

The district court's analysis makes clear that a large factor contributing to its rulings was the decided factual inadequacy of Mr. Binder's evidential proffer. Indeed, the district court noted that, as to certain matters, Mr. Binder's proffer "failed miserably" to meet the rigors of Rule 56(e):

> Plaintiff moves for clarification and/or reconsideration of the Court Order striking the declarations of Thomas Tollefson. (Dkt. #391.) The Order of February 14, 1997, struck the Tollefson declarations submitted by Plaintiffs both in support and in opposition to various motions for summary judgment. ***In finding that the declarations failed miserably in meeting the requirements of Rule 56(e), the Court struck the declarations because of lack of foundation as to personal knowledge and because the declarant's expertise and credentials had not been established as to the opinions he sought to assert.***

App. 1, 26 (emphasis added).

Mr. Binder's dissatisfaction with certain Rule 56 evidentiary rulings therefore manifestly fails to supply grounds for granting the petition. Indeed, even the dissenting judge affirmed the district court as to these matters. Again, by clamoring about Rule 56 evidential rulings, the Petitioner underscores the utter conventionality of the decision below. This case does not present any critical question of national import.

IV.

AS TO THE PETITION'S MISSTATEMENTS

The Petition does contain several misstatements. With intended brevity, these misstatements, as related to Messrs. Wilson and Fitchey include:

- The firm of Elam & Burke, P.A. represents only Messrs. Wilson and Fitchey in this proceeding, not Mr. Stevens

- Petitioner's repeated references that the Golden Brands distributor contract was terminated in 1991, is incorrect; AVBC and Golden Brands continued their relationship until well into 1994

- The Petition asserts that the AVBC product was "defective" when in reality, there was a shelf-life adjustment that needed to occur, an adjustment which was subsequently implemented

- Appendix B bears the incorrect date of the district court's February 14th Decision. The proper year is 1997, not 1999.

CONCLUSION

This Petition at best presents a factual quarrel with conventional discretion-laden rulings issued under well-settled precedent, Rule 56, and 28 U.S.C. § 1367. This Petition in no way presents any issue of national significance, nor does a conflict of precedent exist which in any way requires this Court's guidance. Accordingly, Mr. Binder's Petition should be politely, but firmly, denied.

DATED this 21st day of January, 2000.

ELAM & BURKE, P.A.

JEFFERY J. VENTRELLA, Of the Firm
Attorneys for Respondents
Wilson and Fitchey

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

ALBERT AND ESTELLE BINDER, in their individual capacities and on behalf of one or more classes of persons similarly situated, Plaintiffs, vs. THOMAS GILLESPIE, MARIE MULLEN GILLESPIE, IAN R. WILSON, T. GORDON SIM, DIANE L. KARBAN, DIANE KARBAN BARKER, CARY S. FITCHEY, LEE STRADER, JOHN A. GOOD, ROBERT BAHOSHY, MARK L. STEVENS, AQUA VIE BEVERAGE CORPORATION AND DELOITTE & TOUCHE, Defendants.	Case No. CV 94-0528-S-MHW **ORDER**

Currently pending before the Court are the following motions:

(1) Plaintiff's motion to strike the answer of Defendant Deloitte & Touche (Dkt. #351) filed February 6, 1997;

(2) Plaintiff's motion for order that complaint plead punitive damages (Dkt. #363) filed February 11, 1997;

(3) Defendant Karban's motion to dismiss second cause of action in the first amended complaint (Dkt. #370) filed February 18, 1997;

(4) Plaintiff's motion for reconsideration of Court's order imposing sanctions (Dkt. #383) filed March 21, 1997;

(5) Plaintiff's motion for entry of final judgment (Dkt. #385-1) filed March 22, 1997;

(6) Plaintiff's motion for certification of appeal under 28 U.S.C. § 1292(b) (Dkt. #285-2) filed March 22, 1997;

(7) Plaintiff's motion to clarify or for reconsideration of the admissibility and the Court's reliance on Defendant Deloitte and Touche's two expert reports and the Wright Houlihan report for purposes of the Court's ruling on the Defendants' motions for summary judgment (Dkt. #287) filed March 22, 1997;

(8) Plaintiff's motion for order and entry of judgment on Binders' individual claims against Defendant Gillespies following entry of default (Dkt. #389) filed March 22, 1997;

(9) Plaintiff's motion to clarify or for reconsideration of the Court's order striking the declaration of Thomas Tollefson (Dkt. #391) filed March 22, 1997;

(10) Defendants Wilson, Sim, Stevens and Fitchey motion for clarification of summary adjudication and entry of judgment (Dkt. #393) filed March 21, 1997;

(11) Defendant Deloitte & Touche's motion for summary judgment against Albert Binder (Dkt. #396) filed March 21, 1997;

(12) Defendant Good's motion to dismiss (Dkt. #402) filed March 24, 1997;

(13) Plaintiff's motion to strike Defendant Deloitte & Touche's expert reports and materials submitted in support of its motion for summary judgment (Dkt. #415) filed April 8, 1997.

On June 19, 1997, the Court conducted a hearing, has fully reviewed the motions and related pleadings and is now sufficiently prepared to issue a ruling in this matter.

I.

BACKGROUND

On February 14, 1997, the Court issued an Order which concluded that the Plaintiffs, as a class, were unable to prove essential elements of its Section 10b and Rule 10b-5 claims. (Dkt. #366). As a result, the Court found that the Plaintiffs were unable to sustain the class status of the action because individual issues predominated over common ones. The Court found as a matter of law that the Defendants were entitled to summary judgment regarding Count One of the class complaint. Moreover, the Court declined to exercise supplemental jurisdiction over the related state law class claims. As a result of the class decertification, the only remaining claims are the individual federal and state claims of the named Plaintiff, Albert Binder ("Binder").

The Court will first address the parties' motions to dismiss and/or for summary judgment. Second, the Court will take up the various motions for clarification and/or reconsideration. Third, the Court will address the motions regarding certifying the case for appeal and finally any miscellaneous motions.

II.

MOTIONS TO DISMISS AND/OR FOR SUMMARY JUDGMENT

Various Defendants advance dispositive motions aimed at the merits of Binder's individual claims. Defendant Karban moves to dismiss Count Two of the complaint lodged against her and also petitions the Court to decline to exercise supplemental jurisdiction over the remaining state law claims. (Dkt. #370). Defendant Good moves to dismiss the complaint for failure to state a cause of action. (Dkt. #402). Defendants Wilson, Sim, Stevens and Fitchey move for clarification regarding issues of summary adjudication and entry of judgment. (Dkt. #393). Finally, Defendant Deloitte & Touche moves for summary judgment against Binder's individual claims. (Dkt. #396).

Legal Standards:

1. Rule 56 Motion for Summary Judgment:

When reviewing a motion for summary judgment, the proper inquiry is whether "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine

issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c) (1993). A moving party who does not bear the burden of proof at trial may show that no genuine issue of material fact remains by demonstrating that "there is an absence of evidence to support the non-moving party's case." *Celotex Corp v. Catrett*, 477 U.S. 317, 325, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). Once the moving party meets the requirement of Rule 56 by either showing that no genuine issue of material fact remains or that there is an absence of evidence to support the non-moving party's case, the burden shifts to the party resisting the motion who "must set forth specific facts showing that there is a genuine issue for trial." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). It is not enough for the [non-moving] party to "rest on mere allegations of denials of his pleadings." *Id.* Genuine factual issues must exist that "can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." *Id.*, at 250.

"When determining if a genuine factual issue . . . exists, . . . a trial judge must bear in mind the actual quantum and quality of proof necessary to support liability." *Id.*, at 249-250. "The mere existence of a scintilla of evidence in support of the [defendant's] position will be insufficient; there must be evidence on which the jury could reasonably find for the [defendants]." *Id.*

The Ninth Circuit has consistently applied the standard for granting summary judgment. *Musick v. Burke*, 913 F.2d 1390 (9th Cir. 1990); *Pelletier v. Federal Home Loan Bank*, 968 F.2d 865 (9th Cir. 1992); *Bieghler v. Kleppe*, 633 F.2d 531 (9th Cir. 1980).

In determining whether a material fact exists, facts and inferences must be viewed most favorably to the non-moving party. To deny the motion, the Court need only conclude that a result other than that proposed by the moving party is possible under the facts and applicable law. *Aronsen v. Crown Zellerbach,* 662 F.2d 584, 591 (9th. Cir. 1981).

The Ninth Circuit has recently emphasized that summary judgment may not be avoided merely because there is some purported factual dispute, but only when there is a "genuine issue of material fact." *Hanon v. Dataproducts Corp.,* 976 F.2d 497 (9th Cir. 1992).

In order to withstand a motion for summary judgment, the non-moving party

> (1) must make a showing sufficient to establish a genuine issue of fact with respect to any element for which it bears the burden of proof; (2) must show that there is an issue that may reasonably be resolved in favor of either party; and (3) must come forward with more persuasive evidence than would otherwise be necessary when the factual context makes the non-moving party's claim implausible.

British Motor Car Distrib. Ltd. v. San Francisco Automotive Indus. Welfare Fund, 882 F.2d 371 (9th Cir. 1989).

2. Rule 129(b) Motion to Dismiss:

The purpose of a Rule 12(b)(6) motion to dismiss is to test the sufficiency of the claim for relief by addressing itself solely to the failure of the complaint to state a claim. When the court is testing the sufficiency of the claims for

relief, the complaint should be construed in a light most favorable to the plaintiff and its allegations taken as true. *Scheuer v. Rhodes,* 416 U.S. 232, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974); *Church of Scientology of Ca. v. Flynn,* 744 F.2d 694, 696 (9th Cir. 1984). The complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claim which would entitle plaintiff to relief. *Conley v. Gibson,* 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957); *Reddy v. Litton Industries, Inc.,* 912 F.2d 291, 293 (9th Cir. 1990). The issue is not whether the plaintiff will ultimately prevail or is likely to prevail, but whether the Plaintiff is entitled to offer evidence to support the claim. *Scheuer, supra.*

In reviewing the allegations of a complaint pursuant to a 12(b)(6) motion raised by a Defendant, legal conclusions, deductions or opinions couched as factual allegations are not given the presumption of truthfulness. 2A *Moore's Federal Practice* § 12.07 (1994). *See e.g. Briscoe v. Lahue,* 663 F.2d 713 (7th Cir. 1981) (Conclusory allegations of a conspiracy without any supporting facts are insufficient to withstand a motion to dismiss); *Davidson v. Georgia,* 622 F.2d 895 (5th Cir. 1980) (Where allegations of unconstitutionality were wholly conclusory, dismissal was proper.); *Mitchell v. Archibald & Kendall, Inc.,* 573 F.2d 429 (7th Cir. 1978) (Dismissal upheld since legal conclusions drawn from pleaded facts are not presumed to be true.).

Discussion

1. Defendant Karban's Motion to Dismiss

Defendant Karban moves pursuant to Rules 12(b)(6) and 15(a) of the Federal Rules of Civil Procedure for an order dismissing Count Two of the amended complaint[1] and requests that the Court decline to exercise supplemental jurisdiction over the remaining state causes of actions against her. Plaintiff opposes the motion, arguing that the Court's Order of February 14, 1997, stated it would retain jurisdiction over Count Two as it pertains to Karban.

In its Order dated November 25, 1996, the Court addressed the Plaintiffs' motion to amend the complaint. (Dkt. #213). The Court allowed the Plaintiffs to amend its complaint regarding only certain specified areas. The Court stated that:

> Plaintiffs, however, will not be allowed to file an amended complaint including: (1) additional claims against Defendant Karban under Section 10b and Rule 10b-5, and section 20A of the Securities Exchange Act of 1934, (2) a separate claim for racketeering under the Idaho Racketeering Act against Defendant Karban, (3) a separate claim against all Defendants for aiding and abetting under Idaho state law, nor (4) a separate conspiracy claim against all the Defendants.

(Dkt. #213 at 9).

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[1] Count Two of the first amended complaint alleges that Karban violated "insider trading" provisions of the federal securities laws including Section 10b, Rule 10b-5 and Section 20A.

Thus, the Court granted the Plaintiffs' motion to amend subject to the terms and conditions outlined in the Order. The Court concluded that the claims lodged against Karban could not proceed because the allegations were untimely and were not among those amendments discussed between the court and the parties at a June 28, 1996, hearing.[2] The Court found that the Plaintiffs could have forwarded those claims at the time the complaint was filed and that to allow the amendment against Karban was prejudicial and justice did not so require. When Plaintiffs lodged and filed the first amended complaint, it inadvertently included the cause of action under Section 10b, Rule 10b-5 and Section 20A against Karban.[3] This was error. As a result of that cause of action being erroneously included in the amended complaint, the Court concluded in its Order of February 14, 1997, that the claim against Defendant Karban existed after the class was decertified. This was error.

The second cause of action should not have been considered by the Court because it should not have been included in the complaint.[4] The Court will rectify the

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[2] At a hearing conducted June 28, 1996, the Plaintiff indicated which portions of the complaint it sought to amend. The Court allowed the Plaintiff to submit a proposed amended complaint based on the Plaintiff's statements. The Court received the proposal and on November 25, 1996, ruled on the Plaintiff's motion to amend.

[3] The aiding and abetting cause of action in Count Five against all Defendants was mistakenly included as well.

[4] The same reasoning applies to Count Five for aiding and abetting liability against all the Defendants. Therefore, that Count will be stricken from the first amended complaint.

error at this time, dismissing Count Two from the amended complaint in its entirety. At this time the only claims remaining against Karban are Binder's individual Count One claim and the related state law claims.

2. Defendant Good's Motion to Dismiss

Defendant John Good moves to dismiss the Plaintiff's first amended complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. (Dkt. #402). Good argues that because the Court decertified the class and declined to exercise supplemental jurisdiction over the state law class claims, it should now rule that Albert Binder as an individual has failed to state a claim against him. Good asserts that there is no allegation in the complaint that he materially aided in making material misrepresentations or that he is connected with any deficiencies in AVBC's forecasting, sales, costs of sales, profit margin, cash flow, distribution network, general and administrative costs, and sales and earnings projections. Good additionally asserts that the Plaintiff has failed to allege sufficient facts showing that he was in a position to control the management of the company, set company policy, keep company books, prepare and sign the company prospectus, prepare quarterly or annual reports, issue press releases, sign registration statements, or sell or offer to sell securities. Finally, Good asserts that the Plaintiff has failed to allege that he made any material misrepresentations to the individual Plaintiff, Albert Binder.

The Plaintiff opposes the motion to dismiss, asserting the dual argument that not only is the motion improper

because Good filed an answer to the first amended complaint, but also that the complaint properly states causes of action upon which relief can be granted. The record reflects that Good filed an amended answer to the first amended complaint on February 11, 1997, and that this filing pre-dated the filing of the motion to dismiss. (Dkt. #357). Therefore, the Court finds that the Rule 12(b)(6) motion is improper at this stage because the movant previously filed an answer to the amended complaint. Thus, without reaching the merits of the motion to dismiss, the Court looks to Rule 12(b) and Rule 56(c) to see if converting the motion to dismiss to one for summary judgment is appropriate.

Based on the record and the parties' submissions, the Court concludes that Good has failed to show as a matter of law that he is entitled to summary judgment. Genuine issues of material fact exist regarding Good's conduct and knowledge as to pertains to the allegations lodged in the amended complaint. Therefore, Good's motion will be denied.

3. Wilson Defendant's Motion for Clarification Regarding Summary Adjudication

The Wilson Defendants move for clarification and summary adjudication regarding Binder's individual claims against them. (Dkt. #393). The Wilson Defendants contend that based on the Court's prior rulings, Binder's individual claim alleged in Count One against Defendant Stevens should be dismissed. In addition, they contend that no genuine issues of material fact exist concerning

Binder's individual claim in Count One against Defendant Sim and that claim should be dismissed as well. If the Court grants the requested relief, the Wilson Defendants would then request that the Court decline to exercise supplemental jurisdiction over the remaining state law claims and enter an entry of judgment pursuant to Rule 54(b) enabling the Plaintiff to appeal the ruling as a matter of right.

The Court has already determined that Binder's individual section 10b claim cannot stand against Defendants Wilson and Fitchey. On March 31, 1996, the Court dismissed Count One against those Defendants ruling that:

> Defendant Wilson did not become a member of the Board of Directors until September of 1992. The Complaint does not allege involvement on his part prior to the time Plaintiffs purchased their stocks in 1991. Similarly, the Complaint does not allege that Defendant Fitchey was involved in the allegedly wrongful conduct that occurred in 1991. Therefore, as a matter of law, the named Plaintiffs cannot assert Count One against Defendants Wilson and Fitchey, and Count One must be dismissed as it relates to the named Plaintiffs and Defendants Wilson and Fitchey.

(Dkt. #64 at 22-23).

The complaint alleges that Stevens became a director of AVBC in approximately July of 1993, and became President and Chief Executive Officer in January of 1994. (Dkt. #217 at 30). There is no allegation in the complaint and none in the record which indicates that Stevens had any involvement with AVBC prior to September 1991, the

time at which Plaintiff purchased his stock. Therefore, for the same reasoning as applies to Defendants Wilson and Fitchey, the Court finds as a matter of law that the Plaintiff cannot assert an individual claim based on Count One against Stevens and that the claim should be dismissed.

However, the Court cannot reach the same conclusion concerning Defendant Sim. The complaint alleges that beginning in July 1991, Sim was a special advisor to AVBC and acted as a quasi officer/director. This activity would predate the purchase of stock by the Plaintiff. Therefore, as a matter of law the Court cannot state that the Plaintiff's individual Count One claim against Sim should be dismissed. The Court concludes that the parties' submissions create a genuine issue of material fact regarding the scope and extent of Sim's involvement with AVBC.

The Court will decline to exercise supplement jurisdiction over the state law claims relating to Defendant Stevens, but will retain jurisdiction over the state law claims relating to Defendant Sim. Pursuant to Rule 54(b), the Court will grant final judgment as it pertains to Defendants Wilson, Stevens and Fitchey on all federal and state counts, both individually and as a class, as alleged in the first amended complaint. No just reason for delay exists as to this entry of judgment.

4. Defendant Deloitte & Touche's Motion for Summary Judgment

Defendant Deloitte & Touche moves pursuant to Rule 56(c) of the Federal Rules of Civil Procedure for summary judgment against Albert Binder's individual claims and

seeks to dismiss the complaint in its entirety.[5] Deloitte asserts that no triable issues of material fact exist with respect to certain elements of Binder's individual claim under section 10b and Rule 10b-5 and that the Court should decline to exercise supplemental jurisdiction over the remaining state law claims.

Deloitte argues that Binder's Section 10b and Rule 10b-5 claims should be dismissed because he purchased his AVBC stock before any alleged misrepresentation or omission by Deloitte was made. Thus, Deloitte contends that Binder will be unable as a matter of law to prove transaction and loss causation, essential elements of a Section 10b and Rule 10b-5 claim. In support of its position, Deloitte points to two facts which it contends show that Binder could not have relied on any alleged misrepresentation or omission by Deloitte. First, Deloitte points out that Binder purchased his stock in September 1991. Second, Deloitte contends that the first public disclosure of any AVBC financial statement audited by Deloitte and alleged to contain any misrepresentation or omission occurred on October 22, 1991. Deloitte asserts that both facts are uncontradicted and undisputed in the record.

To prove a claim for section 10b of the Securities Exchange Act and rule 10b-5 a plaintiff must show:

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[5] Defendant Karban joined in Deloitte's motion for summary judgment. (Dkt. #417). The Court concludes, however, that the factual and legal basis for Deloitte's motion is substantially different than that which would support Karban's motion. The Court finds that Karban has failed, at this time, to provide a sufficient basis for the Court to rule on her motion for joinder or for summary judgment.

> (1) a misrepresentation or omission or other fraudulent device; (2) a purchase or sale of securities in connection with the fraudulent device; (3) scienter by defendant in making the misrepresentation or omission; (4) materiality of the misrepresentation or omission; (5) justifiable reliance by plaintiff (or due diligence against it); and (6) damages resulting from the fraudulent device.

See, Basic v. Levinson, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988); *McCormick v. Fund America Companies,* 26 F.3d 869 (9th Cir. 1994); *Monroe v. Hughes,* 31 F.3d 772 (9th Cir. 1994); *Warren v. Reserve Fund, Inc.,* 728 F.2d 741 (5th Cir. 1984) *reh den.* 734 F.2d 1479 (1984); *Marksman Partners L.P. v. Chantal Pharmaceutical Corp.,* 927 F.Supp. 1297 (C.D.Cal. 1996); *Robert Freedman v. Louisiana-Pacific Corp.,* 922 F.Supp. 377 (D.Ore. 1996).

To validly assert a claim under Section 10b and Rule 10b-5 based on material omissions and misrepresentations, the Plaintiff must prove both transaction causation, that the violations in question caused the Plaintiff to engage in the transaction, and loss causation, that the misrepresentation or omissions caused the harm. *See, McGonigle v. Combs,* 968 F.2d 810, 820 (9th Cir. 1992); *Securities Investor Protection Corp. v. Vigman,* 908 F.2d 1461 (9th Cir. 1990). Moreover, transaction and loss causation are "dual and independent requirements analogous to the basic tort principle that a plaintiff must demonstrate both 'but for' and proximate causation." *McGonigle,* 968 F.2d at 821.

To demonstrate transaction causation, the plaintiff must prove that the violations alleged against the defendant caused the plaintiff to engage in the transaction. In

other words, a plaintiff must demonstrate that he relied on the alleged misrepresentations when he entered into the transaction which caused the harm. *See, Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767, 773 (9th Cir. 1984). Thus, it goes without saying that in order to be harmed in a stock purchase transaction, the alleged misrepresentations and/or omissions must have been made before the stock was purchased. If not, the purchaser will be unable as a matter of law to show transaction causation. *See, Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 651 (9th Cir. 1988) (the actionable conduct must occur before the investors become purchasers of securities).

Deloitte contends that because no public dissemination or disclosure of information by Deloitte regarding AVBC occurred until after Binder purchased his stock, Binder will be unable to show that any of the alleged misrepresentations or omissions induced him to buy. The record is clear that the first public disclosure of financial statements audited by Deloitte was the Form 8 Amendment filed with the Securities Exchange Commission ("SEC") on October 22, 1991, which contained the Deloitte audit report on AVBC's December 31, 1990, financial statements. The Plaintiff has previously argued and continues to argue that Deloitte prepared and/or reviewed AVBC's First and Second Quarter 1991 10-Qs which were filed with the SEC on September 16, 1991. However, the Court previously concluded and again reaches the conclusion that "no persuasive evidence

[exists] in the record that Deloitte reviewed or audited those reports." (Dkt. #366 at 31).[6]

Based on the record and the materials submitted by the parties, the Court concludes that no genuine issues of material fact exist regarding the issue of transaction causation. The record clearly shows that Binder could not have relied on any alleged misrepresentation or omission by Deloitte at the time he purchased his stock because Deloitte had not disseminated or disclosed any audited reports at that time.[7] For this reason, Deloitte is entitled

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[6] The only allegations against Deloitte in the first amended complaint pertaining to unaudited financial statements include the allegation that Defendant Diane Karban "was the person at the Company who was *primarily* responsible, with Deloitte's assistance and advice, for the actual preparation of the Company's audited year-end and unaudited quarterly financial statements." (Dkt. #217 at 19) (emphasis added). In addition, the complaint alleges that Deloitte "regularly reviewed and commented upon the Company's proposed quarterly reports to the SEC, including unaudited financial statements, on Form 10-Q before they were filed with the SEC and other wise publicly disseminated." *Id.* at 40. However, the complaint lacks any detailed factual allegations against Deloitte regarding its involvement with ABVC's unaudited financial statements. The Plaintiff's allegations against Deloitte regarding false and misleading misrepresentations deal with information included or omitted from the *audited* financial statements, not from *unaudited* financial statements.

[7] The Plaintiff alleges that Deloitte is primarily liable based on Section 10b and Rule 10b-5 for misrepresentations and omissions it made in its audited financial statements of AVBC. The Ninth circuit has held that an accounting firm may be held liable for representations made by others if the firm significantly participated in a fraudulent scheme. *See, In re Software Toolwords, Inc.*, 50 F.3d 615 (9th Cir. 1995) (complaint

to judgment as a matter of law relating to Binder's individual claims based on Section 10b and Rule 10b-5.

Deloitte also argues that Binder cannot establish loss causation. To show damages resulting from loss causation, a plaintiff must show that the alleged misrepresentation and omission resulted in the stock's decline in value and that the loss was either a direct result or a reasonably foreseeable result of the misleading statement or omission. *See, In re Worlds of Wonder Securities Lit.*, 35 F.3d 1407 (9th Cir. 1994); *McGonigle*, 968 F.2d at 820. As stated in

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establishes primary liability because plaintiff submitted evidence that auditor played a significant role in drafting and editing the SEC letter). However, the Court concludes that Plaintiff has failed to submit persuasive evidence that Deloitte even reviewed or audited the 1991 10-Q reports. At most, the record reflects that Deloitte may have provided AVBC with stylistic assistance to place the 10-Q reports in proper form. No evidence was submitted that Deloitte reviewed the statements or representations contained in the reports which were clearly marked as "unaudited." *See*, Dkt. #269, Exh. G. *cf, Sloane Overseas Fund, Ltd. v. Sapiens Int'l Corp.*, 941 F.Supp. 1369, 1379 (S.D.N.Y. 1996) (allegations regarding the unaudited financial statements are immaterial with respect to Deloitte; Deloitte issued no statement about these financial statements); *Gruber v. Price Waterhouse*, 776 F.Supp. 1044, 1047-48 (E.D. Pa. 1991) (plaintiff cannot rely on alleged statements by Price Waterhouse because Price did not certify the statements which were clearly marked unaudited and plaintiff cannot contend that he trusted the prospectus merely because Price was associated with it; Price's reputation does not equate with reliance in holding the auditor an insurer of every other participant's work product and representations); *Rich v. Touche Ross & Co.*, 415 F.Supp. 95, 98 (S.D.N.Y. 1976) (a plaintiff cannot rely, as a matter of law, on unaudited financial statements for purposes of a Rule 10b-5 claim against an auditor).

McGonigle, plaintiff "must show that the difference in [the] value of [his] investment was connected to and a result of the misrepresentations or concealments of the defendants, and not from some other cause or causes." *McGonigle*, 968 F.2d at 820 n.9.

Deloitte contends that because Binder purchased his stock before any of the allegedly misleading financial statements and reports audited by Deloitte were disclosed, it would have been impossible for those alleged misrepresentations and/or omissions to have affected the stock price at which Binder purchased.

Because the Court finds that Binder purchased his stock before any audited reports or audited financial statements were disseminated, as a matter of law Binder will be unable to show loss causation to support his Section 10b and Rule 10b-5 claims. As such, the Court concludes that no genuine issues of material fact exist and that Deloitte's motion for summary judgment should be granted. Pursuant to Rule 54(b) the Court will grant final judgment as it pertains to Defendant Deloitte & Touche on all federal and state counts, both individually and as a class, as alleged in the first amended complaint. No just reason for delay exists as to this entry of judgment.

III.

MOTIONS FOR CLARIFICATION AND/OR RECONSIDERATION

The parties seek clarification and/or reconsideration on various issues ruled upon by the Court in its Order of February 14, 1997. Plaintiff moves for reconsideration of

the Court's Order imposing sanctions against him for conduct surrounding the deposition of Golden Brands Distributor. (Dkt. #383). Plaintiff also moves for clarification or for reconsideration of the Court's reliance on expert reports when it granted Deloitte & Touche's motion for summary judgment. (Dkt. #387). Finally, Plaintiff moves for clarification or for reconsideration of the Court's Order striking the declarations of Thomas Tollefson. (Dkt. #391).

Legal Standard:

The legal standard regarding motions for clarification or reconsideration employed in this Court is straightforward. The Ninth Circuit has stated three grounds for which a motion to reconsider may be based: (1) an intervening change in controlling law; (2) the availability of new evidence; or (3) the need to correct clear error or prevent manifest injustice. *See, Painting Industry of Hawaii Market Recover Fund v. U.S. Dept of Air Force,* 756 F.Supp. 452, 453 (D. Haw. 1990) *rev'd on other grounds,* 26 F.3d 1479 (9th Cir. 1994).

In addition, Judge Lodge stated that a motion for reconsideration "is appropriate where 'the court has patently misunderstood a party, or has made a decision outside the adversarial issues presented to the court by the parties, or has made an error not of reasoning but of apprehension.' A motion for reconsideration is not a haven for parties dissatisfied with a court's ruling. It is also not a vehicle designed to enable parties to present to the court additional arguments or to restate issues previously argued." *Palmer v. Higgins,* (D. Idaho Case No.

89-3032, Aug. 27, 1992) citing *Above The Belt, Inc. v. Mel Bohannon Roofing, Inc.*, 99 F.R.D. 99 (E.D. Va. 1983).

Moreover, Judge Boyle has found that:

> It is clear that a motion to reconsider must do two things: (1) "it must demonstrate some reason why the court should reconsider its prior decision;" and (2) "it must set forth facts or law of a strongly convincing nature to induce that court to reverse its prior decision." A court's order may be reconsidered if "the Court made a clear error of law or if the prior order caused a manifest injustice to occur." "In order for a party to demonstrate clear error, the moving party's arguments cannot be the same as those made earlier." It is clear that if a party "simply inadvertently failed to raise the arguments earlier, the arguments are deemed invalid." Thus, in the instant action, the Court must consider whether the Plaintiffs have set forth "facts or law of a strongly convincing nature," which would "induce the Court to reverse its prior decision."

Chapple v. Internal Revenue Serv., (D. Idaho Case No. MS 95-4487, Apr. 18, 1996) (citations omitted).

Discussion

1. Plaintiff's Motion for Reconsideration of Court's Order Imposing Sanctions

Plaintiff moves for reconsideration of the Court's imposition of sanctions pertaining to conduct surrounding the deposition of Golden Brands. (Dkt. #383). The Order of February 14, 1997, imposed sanctions in the

amount of $648.00 against Plaintiff and its counsel pursuant to Federal Rule 26(g)(3). The Court found sanctions appropriate because the Plaintiff failed to notify Deloitte (and the other Defendants) that a subpoena duces tecum had been propounded upon Golden Brands Bottling Company, a non-party to the litigation. Plaintiff attempted to conduct the deposition of Golden Brands using documents produced to Plaintiff pursuant to the subpoena which documents had not been provided to the Defendants. Because Deloitte (and the other Defendants) were unprepared to continue the deposition, it had to be rescheduled and the Court awarded Deloitte its expenses associated with the aborted deposition. *See*, Dkt. #366 at 44.

The Court specifically found that the Plaintiff had obtained documents from Golden Brands pursuant to the unnoticed subpoena duces tecum. The Federal Rules require that notice of a subpoena duces tecum be served upon all parties (*See*, Fed. R. Civ. P. 45 (b)(1)) and that the subpoena be attached to the notice of deposition. (Fed. R. Civ. P. 30(b)(1)). The Court concluded that the subpoena was not attached to the notice of deposition and that the Defendants had no notice that Golden Brands produced the documents. As a sanction pursuant to Rule 26(g)(3) the Court awarded Deloitte its costs and expenses resulting from the deposition for "Plaintiffs' failure to properly provide notice of the subpoena duces tecum pursuant to Rule 45(b)(1) and failure to attach or include the subpoena duces tecum in the Golden Brands' deposition notice in violation of Rule 30(b)(1)." (Dkt. #366 at 45-46).

The Plaintiff asserts that the Court may have failed to take into consideration or take into account the Plaintiffs'

response and opposition to Deloitte's motion. Specifically, Plaintiff contends that the Court may have overlooked the declarations of Robert H. Bretz and Mary M. Park which asserted that the deposition notice included a copy of the subpoena duces tecum.

The Court considered both the declaration of Mr. Bretz and Ms. Park when it found that the subpoena had not been provided in the notice of deposition. The Court found the submitted declarations inadequate to overcome the persuasive evidence contained in the deposition transcript itself wherein each Defendant stated they had neither received notice of the subpoena nor the documents produced by Golden Brands. Again, the Court considered the materials and declarations submitted by the Plaintiff and found them unpersuasive.

The Court finds that Plaintiff has failed to "set forth facts or law of a strongly convincing nature to induce the court to reverse its prior-decision." *Great Hawaiian Financial Corp. v. Aiu*, 116 F.R.D. 612, 616 (D. Haw. 1987). In order for a party to demonstrate that the court has committed clear error, the moving party's arguments cannot be the same as those made earlier. The Court finds that Plaintiff presents the same arguments as the Court previously considered and rejected. Plaintiff's motion for reconsideration regarding the imposition of sanctions will be denied.

2. Plaintiffs' Motion for Clarification/Reconsideration of Court's Order Relying of [sic] Expert Reports

Plaintiff moves for clarification and/or reconsideration of the Court's reliance on certain expert reports in granting Deloitte's motion for summary judgment. (Dkt. #387). In support of its motion for summary judgment, Deloitte submitted the expert reports of M. Chapman Findlay III and D. Dale Willman and a report by Wright Houlihan. Plaintiff asserts that none of the reports were the subject of any affidavit, declaration or evidentiary submission showing the admissibility of such reports and contends that the reports are nothing more than out of court statements, inadmissible for the Court's consideration. Plaintiff maintains that it essentially ignored the statements contained in the reports because it did not believe that the Court would accept and rely on them. Plaintiff also contends that the reports should not have been considered because the drafters were not subject to cross-examination by way of deposition and cite *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986) for the proposition that a party opposing a Rule 56 motion must have an opportunity to conduct discovery so as to be able to fairly oppose the substance of the motion.

Beginning with the Plaintiff's argument that it must be given the opportunity to depose the expert, the Court rejects Plaintiff's contention. *Anderson* does not stand for the position which Plaintiff advances. Plaintiff had the opportunity to conduct discovery and identify experts on its behalf to counter the substance of the Rule 56 motion. Indeed, Plaintiff submitted and the Court considered the

report of Dr. Hekman regarding the merits of the motion for summary judgment. Plaintiff cites no relevant authority for the proposition that an expert submitting a report in conjunction with a motion for summary judgment must be deposed prior to the disposition of the motion.

Plaintiff's argument that the reports were not properly before the Court is similarly flawed. The reports were submitted and authenticated by declaration of Deloitte's counsel and Deloitte alter submitted each expert's declaration attesting to the truth of the statements contained in the reports. These declarations were given before the Court considered the reports and the Court properly relied upon them. Moreover, Plaintiff's assertion that it in effect "ignored" the reports is not a sufficient basis for the Court to now reject the reports. Finally, the Court specifically finds that its consideration of the Wright Houlihan report was not clear error as both parties submitted the report for the Court's consideration. The Court views Plaintiff's objection to the Wright Houlihan report as evidentiary in nature. The Court considers the report as authenticated by both parties and the report originated as part of AVBC's ongoing business and in the course of its business. As such, the Court finds that the business records exception to the hearsay rule would remove the report from any hearsay objection.

In concluding that no genuine issues of material fact existed and that Deloitte was entitled to judgment as a matter of law, the Court primarily relied on existing case law. Summary judgment is appropriate if the moving party who does not have the burden at trial shows that the non-moving party cannot sustain its burden of proof as a matter of law. Deloitte satisfied this test. In opposing

the motion, the Plaintiff failed to submit any evidence which raised a triable issue of material fact. This failure, not the reports submitted by Deloitte, primarily lead to the Court's conclusion.

The Court finds that Plaintiff has not shown that the previous ruling bears clarification or reconsideration. Plaintiff has failed to "set forth facts or law of a strongly convincing nature to induce the court to reverse its prior decision." *Great Hawaiian Financial Corp. v. Aiu*, 116 F.R.D. 612, 616 (D. Haw. 1987). In order for a party to demonstrate that the court has committed clear error, the moving party's arguments cannot be the same as those made earlier or arguments which could have been made earlier but were not. Plaintiff's motion for clarification and/or reconsideration regarding the use of the expert reports will be denied.

3. Plaintiffs' Motion for Clarification/Reconsideration of Court's Order Striking Tollefson Declarations

Plaintiff moves for clarification and/or reconsideration of the Court Order striking the declarations of Thomas Tollefson. (Dkt. #391). The Order of February 14, 1997, struck the Tollefson declarations submitted by Plaintiffs both in support and in opposition to various motions for summary judgment. In finding that the declarations failed miserably in meeting the requirements of Rule 56(e), the Court struck the declarations because of lack of foundation as to personal knowledge and because the declarant's expertise and credentials had not been established as to the opinions he sought to assert.

The Plaintiff now seeks clarification as to which portions of the declarations were stricken.[8] Plaintiff contends that nothing more than the objectionable opinion testimony should be excluded and that the documents and materials identified and referenced in the declarations should remain part of the record. Plaintiff also seeks clarification regarding which declarations were stricken. Plaintiff asserts that if the Court intended to strike more than merely the objectionable opinion testimony, the Court should reconsider its decision.

The Wilson Defendants and Defendant Deloitte & Touche joined in moving to strike the Tollefson declarations submitted in conjunction with the motions for summary judgment including: (1) the 15 page declaration submitted in support of the Plaintiffs' motion for summary judgment against Deloitte (Dkt. #269); (2) the 3 page supplemental declaration submitted with the Plaintiffs' motion for summary judgment of issues of liability against Deloitte (Dkt. #268); (3) the 26 page declaration submitted with Plaintiffs' opposition to Deloitte's motion for summary judgment (Dkt. #306); (4) the 8 page declaration submitted with the Plaintiffs' motion for summary judgment against Defendant Wilson (Dkt. #278); and (5) 15 page declaration submitted in support of Plaintiffs' joint opposition to the Wilson Defendants' motion for

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[8] Subsequent to the June 19, 1997, hearing, Defendant Deloitte & Touche filed a supplemental memorandum and request in response to Plaintiff's motion for clarification and/or reconsideration of the Court's Order striking the Tollefson declarations. The Court views Deloitte's supplemental response and request as unnecessary in light of the Court's ruling below and therefore, will not consider the merits of the request.

summary judgment. (Dkt #320). No motion to strike was made regarding the 2 page declaration submitted with the exhibits in support of Plaintiffs' motion for summary judgment against Defendant Wilson.

Because the parties may be unsure which declarations were stricken, the Court will clarify its ruling. The Court has stricken the following documents: (1) the 15 page declaration submitted in support of the Plaintiffs' motion for summary judgment against Deloitte (Dkt. #269); (2) the 3 page supplemental declaration submitted with the Plaintiffs' motion for summary judgment of issues of liability against Deloitte (Dkt. #268); (3) the 26 page declaration submitted with Plaintiffs' opposition to Deloitte's motion for summary judgment (Dkt. #306); (4) the 8 page declaration submitted with the Plaintiffs' motion fur summary judgment against Defendant Wilson (Dkt. #278); and (5) the 15 page declaration submitted in support of Plaintiffs' joint opposition to the Wilson Defendants' motion for summary judgment. (Dkt. #320).

Although the Court struck the declarations, it did not strike and did consider properly identified and authenticated exhibits such as, deposition testimony, discovery responses, business records, and public records which were attached to the declarations. Thus, to the extent that the declaration merely identified these exhibits, the Court did not consider those "statements" as stricken, even though it indicated that the declarations were stricken as a whole. However, the Court did not consider exhibits personally prepared by Tollefson or other unauthenticated exhibits, including charts summarizing dates or trends of various events in the life of AVBC, because Tollefson failed to establish his expertise or credentials as

to the summaries or exhibits he sought to provide. Therefore, the Court grants in part Plaintiff's motion to clarify and/or reconsider its Order striking the Tollefson declarations consistent with the foregoing discussion.

IV.

CERTIFYING THE CASE FOR APPEAL

The Plaintiff seeks the Court to certify the case for appeal as it now stands before the Court decides any further dispositive motions. As such, the Plaintiff moves for an entry of judgment which will allow the Plaintiff to appeal the case as a final judgment. (Dkt. #385-1). Alternatively, the Plaintiff moves the Court to certify the case for appeal under 28 U.S.C. § 1292(b) and for an order staying the remaining claims pending the appeal. (Dkt. #385-2). The Court will now take up Plaintiff's related motions.

Legal Standard:

Rule 54(b) of the Federal Rules of Civil Procedure provides for the entry of final judgment as to one or more but fewer than all of the claims or parties in cases involving multiple claims or multiple parties:

> When more than one claim for relief is presented in an action, whether as a claim, counterclaim, cross-claim, or third-party claim, or when multiple parties are involved, the court may direct the entry of final judgment as to one or more but fewer than all of the claims or parties only upon an express determination that there is no just reason for delay and upon an express

> direction for the entry of judgment. In the absence of such determination and direction, any order or other form of decision, however designated, which adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties shall not terminate the action as to any of the claims or parties, and the order or other form of decision is subject to revision at any time before entry of judgment adjudicating all the claims and the rights and liabilities of all the parties.

Fed. R. Civ. P. 54(b).

In order to enter a final judgment pursuant to Rule 54(b), the court must first determine that a final judgment has occurred under 28 U.S.C. § 1291. *Sears, Roebuck & Co. v. Mackey,* 351 U.S. 427, 438, 76 S.Ct. 895, 100 L.Ed. 1297 (1956) (Rule 54(b) scrupulously recognizes the statutory requirement of a "final decision" under Section 1291 as a basic requirement for an appeal to the Court of Appeals.).[9] The court's decision must be a judgment in the sense that it is a ruling upon a cognizable claim for relief, and it must be "final" in the sense that it is "an ultimate disposition of a claim entered in the course of a multiple claims actions." *Id.; Curtiss-Wright Corp. v. General Electric Co.,* 446 U.S. 1, 7, 100 S.Ct. 1460, 64 L.Ed.2d 1 (1980).

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[9] Section 1291 provides in part that:

> The courts of appeals (other than the United States Court of Appeals for the Federal Circuit) shall have jurisdiction of appeals from all final decisions of the district courts of the United States . . . except where a direct review may be had in the Supreme Court.

28 U.S.C. § 1291.

28 U.S.C. § 1292(b) provides that:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals which would have jurisdiction of an appeal of such action may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order: Provided, however, That application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order.

28 U.S.C. § 1292(b).

Discussion:

Plaintiff moves pursuant to Rule 54(b) and 28 U.S.C. § 1292(b) for an order allowing immediate appeal to the Ninth Circuit Court of Appeals of the Court's previous rulings, including the Court Order of February 14, 1997, which decertified the class status of the case. Conversely, Defendants' argue that the Court should determine Albert Binder's individual claims which would allow an appeal as a matter of right under 28 U.S.C. § 1291 and Rule 54(b).

The Court concluded above that Albert Binder could not sustain his individual federal claims against Defendants Wilson, Stevens, and Fitchey and Defendant Deloitte & Touche. As to these four Defendants the Court will decline to exercise supplemental jurisdiction of the individual state law claims. Previously, on February 14, 1997, the Court concluded that no class claims, either federal or state, existed against these Defendants as well. Based on the foregoing, and pursuant to Rule 54(b), the Court will grant final judgment as it pertains to Defendants Wilson, Stevens, and Fitchey and Defendant Deloitte & Touche on all federal and state counts, both class and individual claims, alleged in the first amended complaint. No just reason for delay exists as to this entry of judgment.

Because final judgment under Rule 54(b) is being entered, the Court need not certify the action for appeal under 28 U.S.C. § 1292(b). In addition, the Court will not set any of the remaining claims for trial pending the disposition of appeal, if any. Moreover, the Court sees no reason to toll the statute of limitations for the class claims. If the Court's decisions dismissing the Plaintiff's claims is reversed on appeal, no prejudice exists because the reversal will apply retroactively to the date the Court issued its decision. If the Court's decision is affirmed, that ruling will sustain the finding that the class action was improper and the conclusion that class claims were improperly alleged.

V.

MISCELLANEOUS MOTIONS

The Plaintiff has filed four miscellaneous motions which will be addressed at this time. The Plaintiff has moved to strike the answer filed by Defendant Deloitte and Touche to the first amended complaint. (Dkt. #35). The Plaintiff also moves to strike expert reports and other material submitted by Defendant Deloitte in support of its motion for summary judgment against Albert Binder. (Dkt. #415). Further, Plaintiff seeks a Court order that the first amended complaint properly pleads a claim for punitive damages and moves that such a claim be included in the complaint. (Dkt. #363). Finally, Plaintiff moves for an order and entry of default against Thomas and Marie Gillespie. (Dkt. #389). These motions will be taken in turn.

1. Plaintiffs' Motion to Strike Deloitte's Answer

Plaintiff moves pursuant to Rule 12(f) of the Federal Rules of Civil Procedure for an order striking Deloitte & Touche's answer to the first amended complaint. (Dkt. #351). Plaintiff contends that the answer fails to respond to the allegations of the complaint and includes new and different affirmative defenses not previously set forth in the Defendant's original answer. Plaintiff argues that rather than answering the complaint, Deloitte instead responded that it was declining to answer the allegations contained in the Complaint pending the Court's ruling on outstanding motions.

Deloitte opposes the motion and argues that in response to the amended complaint it filed a motion to dismiss the state law claims and a motion to strike certain allegations in the complaint. Deloitte contends that it was under no duty to answer the complaint until after the Court ruled on the motions. Deloitte cites Rule 12(a) which provides in part that:

> A defendant shall serve an answer within 20 days after the service of summons and complaint upon that defendant . . . The service of a motion permitted under this rule alters these periods of time as follows, unless a different time is fixed by order of the court: (1) if the court denies the motion or postpones its disposition until the trial on the merits, the responsive pleading shall be served within 10 days after notice of the court's action;

Fed. R. Civ. P. 12(a).

Deloitte contends that it answered the majority of the Plaintiff's allegations in the first amended complaint and that it reserved its right to answer the remaining allegations once the Court ruled on the pending motion to strike and motion to dismiss.

Deloitte also maintains that the affirmative defenses asserted in the amended answer were also asserted in the original answer, although differently numbered and does admit that it is alleging one new affirmative defense in its amended answer. Deloitte contends that it is entitled to assert the new affirmative defense because the amended complaint supersedes the original complaint and renders it of no legal effect. As such, Deloitte argues that it is able to assert new defenses in its amended answer. Deloitte

contends that the new defense merely asserts the legal positions espoused by the United States Supreme Court in *Central Bank of Denver v. First Interstate Bank of Denver, N.A.*, 114 S.Ct. 1439 (1994) which provides that private plaintiffs may not maintain suits for aiding and abetting liability under Section 10b of the Securities Exchange Act of 1934. Deloitte states it asserted the defense because of the new allegations in the amended complaint which allege that Deloitte aided, abetted and assisted.

Finally, Deloitte argues that the cross-claim against AVBC was included in its original answer and that it merely reasserted all cross-claims previously raised. Deloitte contends it has no intention of pursuing the cross-claim while AVBC is in bankruptcy and subject to the automatic stay provision in the Bankruptcy Act.

The Court finds that based on Rule 12(a) Deloitte was under no obligation to respond to the amended complaint until after the Court had ruled on the Rule 12(b) motions. The Court denied Deloitte's motion to strike certain allegations from the complaint and found Deloitte's motion to dismiss state law claims moot. So as to not prejudice the Defendants, the Court finds that they would be given a reasonable amount of time to answer the amended complaint following the February 14, 1997, Order issued by the Court. The Court finds that Deloitte's affirmative defenses, although numbered differently, were carried over from the original answer except for the Eighth Affirmative Defense. The Court concludes that the new defense in no manner prejudices Plaintiff because Deloitte would be able to assert the Supreme Court decision in *Central Bank of Denver* regardless whether the defense was contained in the answer. Finally, the Court

concludes the Deloitte merely reasserted all its cross-claims, including the claim against AVBC, which were included in the original answer. Of course, Deloitte would not be permitted to advance the claim absent relief from the automatic stay provisions of the Bankruptcy Act. For these reasons the Plaintiff's motion to strike Deloitte's answer will be denied.

2. Plaintiff's Motion to Strike Deloitte's Expert Reports and Other Material

Plaintiff moves to strike the expert reports and other materials submitted by Defendant Deloitte & Touche in conjunction with its motion for summary judgment against Binder's individual claims. (Dkt. #415). Plaintiff asserts the identical arguments raised in its motion to clarify and/or reconsider the Court's reliance on the reports and materials for the purposes of the Court's ruling on motions for summary judgment against the class claims. (Dkt. #387). For the same reasons which denied the Plaintiff's motion for clarification and/or reconsideration, the Court denies the Plaintiff's motion to strike.

3. Plaintiff's Motion that Complaint Properly Pleads Punitive Damages

Plaintiff moves pursuant to Rule 7(b) of the Federal Rules of Civil Procedure and Idaho Code Section 6-1604 for an order that the first amended complaint properly pleads punitive damages. Section 6-1604 provides that no

claim for punitive damages may be filed unless the plaintiff establishes a reasonable likelihood of proving facts at trial sufficient to support an award of punitive damages. Plaintiff contends that the facts of the case show that there is a reasonable likelihood of proving facts at trial to support an award of punitive damages against Defendants Karban, Wilson, Sim, Fitchey, Stevens and Deloitte. Plaintiff agrees not to seek an award of punitive damages against Defendants Thomas Gillespie, Marie Mullen Gillespie or Defendant Good.

Because final judgment pursuant to Rule 54(b) as [sic] been entered against certain Defendants, the Court will dismiss without prejudice the Plaintiff's motion to plead punitive damages. The Plaintiff may renew the motion in the event that any of the claims alleged in the first amended complaint are scheduled for trial on the merits.

4. Plaintiff's Motion for Order and Entry of Default Against the Gillespies

Plaintiff moves pursuant to Federal Rules 55(b)(2), 54(b) and 54(d) for an immediate entry of final judgment against Defendants Thomas and Marie Mullen Gillespies (the "Gillespies") for damages and attorney fees in the amount of $35,000.00 (Dkt. #389). Plaintiff states that default has already been entered against the Gillespies and now seeks entry of final judgment so as to commence the running of the time period to appeal the entry of default and to establish a basis for the Plaintiff's third-party claim against an insurance policy maintained by AVBC.

The Court finds that entry of default and final judgment are appropriate and that the Plaintiff has shown entitlement to the amount of damages demanded based on the pleadings.[10] The Plaintiff submitted an affidavit detailing his loss at $5,736.00. The Court will enter final judgment against Thomas Gillespie and Marie Mullen Gillespie in this amount, including prejudgment interest at the current rate.

In addition, Plaintiff seeks $25,000 in attorney fees. The awarding of attorney fees in actions such as this lie in the sound discretion of the Court. *See, Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 516 F.2d 172, 192 (2nd Cir. 1975); *Warren v. The Reserve Fund, Inc.*, 728 F.2d 741, 748 (5th Cir. 1984). The Court finds that Plaintiff has failed to submit any legal authority which would support an award of attorney fees. The Court will grant Plaintiff 10 days from receipt of this Order to submit supplemental briefing regarding the legal basis for attorney fees. The supplemental briefing should include a detailed affidavit establishing the exact amount of fees he is seeking. After reviewing the briefing, the Court will consider if a hearing regarding the awarding of fees is necessary.

VI.

CONCLUSION

For purposes of clarification the Court will state which claims remain and which claims are subject to Rule

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[10] The Ninth Circuit has provided that a plaintiff must present evidence of damages. *See, Dundee Cement Co. v. Howard Pipe & Concrete Prod., Inc.*, 722 F.2d 1319, 1323 (9th Cir. 1983).

54(b) final judgment. The Court's February 14, 1997, Order found that the class could not sustain Count One against any of the Defendants. Thus, the Court decertified the class and declined to exercise supplemental jurisdiction over the class' state law claims. This Order and the February 14 Order produce the following results:

The following claims remain before the Court:

(1) Binder's individual claims based on Count One, Four, Seven, Eight, Nine, Ten and Eleven against Defendant Sim, Defendant Karban, Defendant Good, Defendant Strader, Defendant Bahoshy, and Defendant AVBC.

The following claims have been dismissed:

(1) All class claims based on Count One against all Defendants. Moreover, supplemental jurisdiction will not be exercised regarding the class' state law claims.

(2) Binder's individual Count Two against Defendant Karban.

(3) Binder's individual Count Five against all Defendants.

The following claims have been disposed via final judgment pursuant to Rule 54(b):

(1) all class and individual claims, both federal and state, against Defendant Deloitte & Touche, Defendant Wilson, Defendant Stevens, Defendant Fitchey, Defendant Thomas Gillespie and Defendant Marie Mullen Gillespie.

ORDER

Based upon the foregoing, the Court having been fully informed in the premises, IT IS HEREBY ORDERED that

(1) Plaintiff's motion to compel attendance (Dkt. #232-2) is MOOT;

(2) Plaintiff's motion to strike the answer of Defendant Deloitte & Touche (Dkt. #351) is DENIED;

(3) Plaintiff's motion for order that complaint plead punitive damages (Dkt. #363) is DENIED without prejudice. Plaintiff may renew the motion if and when the remaining claims are set for trial;

(4) Defendant Karban's motion to dismiss second cause of action in the first amended complaint (Dkt. #370) is GRANTED;

(5) Plaintiff's motion for reconsideration of Court's order imposing sanctions (Dkt. #383) is DENIED;

(6) Plaintiff's motion for entry of final judgment (Dkt. #385-1) is GRANTED as it pertains to Defendants Wilson, Stevens and Fitchey and to Defendant Deloitte & Touche regarding all individual and class claims based on federal and state law;

(7) Plaintiff's motion for certification of appeal under 28 U.S.C. § 1292(b) (Dkt. #285-2) is DENIED;

(8) Plaintiff's motion to clarify or for reconsideration of the admissibility and the

Court's reliance on Defendant Deloitte and Touche's two expert reports and the Wright Houlihan report for purposes of the Court's ruling on the Defendants' motions for summary judgment (Dkt. #287) is DENIED;

(9) Plaintiff's motion for order and entry of judgment on Binders' individual claims against Defendant Gillepies [sic] following entry of default (Dkt. #389) is GRANTED in the amount of $5,736.00, including pre-judgment interest. Plaintiff's motion for attorney fees is STAYED. Plaintiff shall submit supplemental briefing regarding the legal basis for attorney fees and a detailed affidavit supporting the exact amount of claimed fees within 10 days of receipt of this Order;

(10) Plaintiff's motion to clarify or for reconsideration of the Court's order striking the declaration of Thomas Tollefson (Dkt. #391) is GRANTED in part and DENIED in part and is clarified consistent with this Order;

(11) Defendants Wilson, Sim, Stevens and Fitchey motion for clarification of summary adjudication and entry of judgment (Dkt. #393) is GRANTED in part and DENIED in part;

(12) Defendant Deloitte & Touche's motion for summary judgment against Albert Binder (Dkt. #396) is GRANTED;

(13) Defendant Good's motion to dismiss (Dkt. #402) is DENIED;

(14) Plaintiff's motion to strike Defendant Deloitte & Touche's expert reports and materials submitted in support of its motion for summary judgment (Dkt. #415) is DENIED.

DATED this the 3 day of July, 1997.

/s/ Mikel H. Williams
MIKEL H. WILLIAMS
Chief United States
Magistrate Judge

MAILING CERTIFICATE

I HEREBY CERTIFY that a true and correct copy of the foregoing was mailed this ___ day of ___, 19___, to the following parties:

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_____

by Deputy Clerk